MODIFICATION TO THE MULTIEMPLOYER PENSION PLAN AMENDMENTS ACT AND PENSION PLAN INVESTMENTS IN THE RESIDENTIAL MORTAGE MARKET

HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 2232, S. 2860 and S. 2918

SEPTEMBER 27, 1982

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MODIFICATION TO THE MULTIEMPLOYER PENSION PLAN AMENDMENTS ACT AND PENSION PLAN INVESTMENTS IN THE RESIDENTIAL MORTGAGE MARKET

MONDAY, SEPTEMBER 27, 1982

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON SAVINGS,
PENSIONS, AND INVESTMENT POLICY,
Washington, D.C.

The committee met, pursuant to notice, at 2:42 p.m. in room 2221, Dirksen Senate Office Building, Hon. John H. Chafee (chairman) presiding.

Present: Senators Chafee and Dole.

[The press release announcing the hearing, the description of S. 2232, S. 2860, and S. 2918 by the Joint Committee on Taxation and the opening statements of Senators Chafee, Dole, and Mitchell follow:]

Revised Press Release No. 82-164

P R E S S R E L E A S E

FOR IMMEDIATE RELEASE
September 20, 1982

UNITED STATES SENATE
COMMITTEE ON FINANCE
Subcommittee on Savings, Pensions,
and Investment Policy
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY ADDS S. 2232 TO SEPTEMBER 27, 1982 HEARING

Senator John H. Chafee (R., R.I.), Chairman of the Subcommittee on Savings, Pensions, and Investment Policy, announced today that the Subcommittee hearing on Monday, September 27, 1982, will include S. 2232 in addition to S. 2860 and S. 2918, as previously announced.

The hearing will begin at 2:00 p.m. in Room 2221 of the Dirksen Senate Office Building.

The following legislative proposals will be considered:

S. 2232--Introduced by Senator Helms. S. 2232 would provide a special exclusion from gross income of qualified plan distributions that were made within 2 calendar years and rolled over into an individual retirement account.

S. 2860--Introduced by Senator Danforth for himself and others. S. 2860 would eliminate the retroactive effective date of the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980, P.L. 96-364.

S. 2918--Introduced by Senator Chafee for himself and others. S. 2918 would generally create exemptions to the Employee Retirement Income Security Act of 1974 to permit more investments by employee benefit plans in the residential mortgage market.

DESCRIPTION OF TAX BILLS

(S. 2232, S. 2860, and S. 2918)

Relating to

CERTAIN PENSION PLAN PROVISIONS

Scheduled for a Hearing

on

September 27, 1982

Before the

Subcommittee on Savings, Pensions, and Investment Policy

of the

Senate Committee on Finance

Prepared by the Staff

of the

Joint Committee on Taxation

September 25, 1982

JCX-42-82

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INTRODUCTION

This document provides a description of the three tax bills scheduled for a hearing on September 27, 1982, before the Senate Finance Subcommittee on Savings, Pensions, and Investment Policy. The three bills are: (1) S. 2232 (introduced by Senator Helms), relating to exclusion from gross income of qualified plan distributions that were made within two taxable years and rolled over into an individual retirement account (relief of John W. Pope); (2) S. 2860 (introduced by Senators Danforth and Chafee), relating to the effective date of the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980; and (3) S. 2918 (introduced by Senator Chafee and others), relating to amendment of the Code provisions to permit more investments by employee benefit plans in residential mortgages.

The first part of the document is a summary of the bills. This is followed in the second part with a more detailed description of the bills, including present law, issues, effective dates, and revenue effects.

I. SUMMARY

1. S. 2232--Senator Helms

Qualifying Rollover Contributions

If a lump sum distribution is paid to an employee under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over within 60 days to another qualified plan or to an IRA (an individual retirement account, annuity or bond).

A distribution to an employee from a qualified plan is not a lump sum distribution unless (1) the distribution consists of the balance to the credit of the employee under the plan, and (2) the distribution is made within one taxable year of the recipient.

The bill provides special relief for certain pension plan distributions received by Mr. John W. Pope during 1976 and 1977 and transferred by him to an individual retirement account.

Under the bill, the transfers would be treated as a tax-free rollover.

2. S. 2860--Senators Danforth and Chafee

Liability of Employers Withdrawing from Multiemployer Pension Plans

Prior to the enactment of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), an employer's obligation to contribute to a multiemployer pension plan generally ended when the employer withdrew from the plan, unless, within 5 years after the withdrawal, the plan terminated with insufficient assets to provide benefits at the level guaranteed by the Pension Benefit Guaranty Corporation (PBGC).

Under MPPAA, an employer who withdraws from a multiemployer pension plan generally is liable for a portion of the plan's unfunded obligations determined at the time of the withdrawal. Although the provisions of MPPAA generally became effective on September 26, 1980, the date of enactment, the withdrawal liability provisions were made effective retroactively to withdrawals which occurred on or after April 29, 1980.

The bill provides that withdrawal liability will be imposed only with respect to withdrawals occurring on or after September 26, 1980.

3. S. 2918--Senators Chafee, Bentsen, Wallop, Mitchell, Danforth, Boren, Grassley, Matsunaga, Symms, Baucus, Durenberger, and others

Investments in Residential Home Mortages by Employee Benefit Plans

The self-dealing rules under both the Internal Revenue Code and the non-Code provisions of the Employee Retirement Income Security Act of 1974 prohibit certain transactions between an employee benefit plan and certain related persons (a party in interest or a disqualified person). Also, they prohibit use of plan assets or income for the benefit of a related person. However, present law permits a plan to make mortgage commitments and loans on residential dwellings, which might otherwise constitute a prohibited transaction, if certain conditions are met. Included among the conditions is the requirement that the decision to issue the mortgage be made by an independent real estate manager. In addition, financing must be provided through an established mortgage lender which is independent of the plan and is engaged in making or purchasing mortgage investments in the normal course of business. The lender must also have approval to participate in Federal or State residential mortgage programs.

Although present law exempts such residential mortgage loans from the prohibited transaction rules, such loans must be consistent with ERISA's prudent man standard for plan investments as well as the Act's other fiduciary standards.

The bill would exempt qualified mortgage transactions from the prohibited transaction rules if the transaction is in accordance with customary practices in the residential mortgage industry.

The bill's provisions also would supersede any State laws relating to qualified mortgage transactions engaged in by employee benefit plans.

II. DESCRIPTION OF BILLS

1. S. 2232--Senator Helms

Qualified Rollover Contributions

Present law

If a lump sum distribution is paid to an employee (or the spouse of a deceased employee) under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over, within 60 days, to another qualified plan or to an IRA (an individual retirement account, annuity, or bond).

A distribution from a qualified plan is not a lump sum distribution unless it consists of the balance to the credit of the employee under the plan, and is made within one taxable year of the recipient.

Issue

The issue is whether a distribution made to Mr. John W. Pope, consisting of payments made in December 1976, and January 1977, which is not a lump sum distribution because it was not paid within one taxable year, should be eligible for tax-free rollover treatment.

Explanation of the bill

The bill provides special relief for certain pension plan distributions received by Mr. John W. Pope from the Variety Wholesalers, Inc., pension plan during 1976 and 1977. Mr. Pope transferred amounts recovered from the plan to an IRA. Under the bill, the transfers would be treated as qualifying rollover contributions. Thus, to the extent the payments were, in fact, rolled over to an IRA within 60 days of receipt, the distribution will not be includible in Mr. Pope's income.

In addition, the bill provides an extension of the usual period of limitation for filing a claim for credit or refund of taxes paid (generally, three years after the later of (1) the date prescribed for filing the tax return, or (2) the date the return was actually filed). Under the bill, the statutory period of limitation is extended to permit Mr. Pope to file a claim for credit or refund attributable to changes made by the bill within one year of the date of enactment.

Effective date

The bill is effective upon enactment.

Revenue effect

It is expected that the bill would have a negligible impact on revenues.

2. S. 2860--Senators Danforth and Chafee

Liability of Employees Withdrawing from Multiemployer Pension Plans

Present law

The liability of an employer who withdraws from a multiemployer pension plan for a portion of the plan's unfunded pension obligations is determined pursuant to title IV of the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, prior to its amendment by the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), an employer's liability generally ended when the employer withdrew from the plan unless, within 5 years after the withdrawal, the plan terminated with insufficient assets to provide benefits at the level guaranteed by the Pension Benefit Guaranty Corporation (PBGC). In the event of such a termination, each employer who maintained the plan during the 5-year period preceding the termination was potentially liable to the PBGC for a share of the insufficiency. An employer's liability generally was limited, however, to 30 percent of its net worth.

MPPAA amended ERISA to provide that an employer who totally or partially withdraws from a multiemployer pension plan generally is liable for a portion of the plan's unfunded obligations determined at the time of the withdrawal (computed under one of several alternative specified methods). Employers in the building and construction or entertainment industries are relieved of withdrawal liability if certain requirements are met. A de minimis exception is provided for relatively small liabilities.

Although the provisions of MPPAA generally became effective on September 26, 1980, the date of enactment, the withdrawal liability provisions were made effective for withdrawals which occurred after April 28, 1980 (the date of Senate Finance Committee markup on a bill extending prior law).

Issue

The issue is whether withdrawal liability should be imposed on employers who withdrew from a multiemployer plan after April 28, 1980, but before September 26, 1980.

Explanation of the bill

The bill provides that withdrawal liability would be imposed under the provisions added by MPPAA only with respect to an employer's withdrawal from a multiemployer plan occurring after September 25, 1980. Liability for withdrawals occurring before

September 26, 1980, would be determined pursuant to the 5-year rule originally provided by ERISA. Thus, for an employer who withdraws before September 26, 1980, liability generally would be imposed only if the plan terminates before the earlier of April 29, 1985, or the expiration of 5 years after the date of the withdrawal, with insufficient assets.

In addition, the bill provides that (1) any liability previously imposed under MPPAA with respect to withdrawals occurring after April 28, 1980, but before September 26, 1980, would be voided, and (2) any amounts paid by an employer to a plan sponsor as a result of the imposition of such liability with respect to a withdrawal occurring prior to September 26, 1980, would be refunded (not of reasonable administrative expenses).

Effective date

The bill would be effective upon enactment.

Revenue effect

It is expected that the bill would have a negligible impact on revenues.

3. S. 2918--Senators Chafee, Bentsen, Wallop, Mitchell, Danforth, Boren, Grassley, Matsunaga, Symms, Baucus, Durenberger, and others

Investments in Residential Home Mortgages by Employee Benefit Plans

Present law

Prohibited transactions

Standards relating to acts of self-dealing with respect to employee benefit plans are provided in both Internal Revenue Code provisions added or amended by the Employee Retirement Income Security Act of 1974 (ERISA) and in the non-Code provisions of ERISA. Under ERISA's non-Code provisions, a fiduciary with respect to an employee benefit plan may not cause the plan to engage in a prohibited transaction with a party in interest (ERISA sec. 406(a)). A prohibited transaction includes any direct or indirect (1) sale or exchange, or leasing of property, between a plan and a party in interest; (2) lending of money or other extension of credit between the plan and a party in interest; (3) furnishing of goods, services, or facilities between the plan and a party in interest; or (4) transfer to, or use by or for the benefit of, a party in interest of any assets of the plan. Parties in interest include, among others, persons providing services to the plan and employees of employers maintaining the plan.

Under the Code provisions of ERISA, an excise tax is imposed on a prohibited transaction involving a disqualified person (Code sec. 4975). Parties in interest generally are also disqualified persons, except that an employee of an employer maintaining a tax-qualified plan generally is a disqualified person only if the employee is an officer, director, highly compensated, or owns a 10-percent interest in the employer.

Both the Code and non-Code provisions of ERISA include an exemption to the prohibited transaction rules under which a plan generally is permitted to make a loan to a plan participant if certain requirements are met. Generally, the loan must bear a reasonable rate of interest, be adequately secured, provide a reasonable repayment schedule, and be made available on a basis which does not discriminate in favor of employees who are officers, shareholders, or highly compensated (ERISA sec. 408(b) and Code sec. 4975(d)).

Prohibited transaction exemption 82-87

The Code and non-Code provisions of ERISA also provide for the granting of other exemptions from the prohibited transaction rules (ERISA sec. 408(a) and Code sec. 4975(c)). Authority to promulgate such exemptions generally is assigned to the Secretary of Labor.

On May 18, 1982, the Secretary of Labor promulgated a prohibited transaction exemption (PTE 82-87) which permits an employee benefit plan to make mortgage commitments and loans on residential dwellings without being deemed to have entered into a prohibited transaction. The exemption applies to (1) the issuance of a commitment by a plan to provide mortgage financing to purchasers of residential dwelling units, either by making or participating in loans made directly to purchasers or by purchasing mortgage loans or participation interests in mortgage loans originated by a third party; (2) the receipt by the plan of a fee in exchange for issuing the commitment; (3) the actual making or purchase of a mortgage loan or participation interest pursuant to a commitment; (4) the direct making or purchase by one or more employee benefit plans of a mortgage loan or a participation interest other than where a commitment has been issued; and (5) if certain requirements are met, the sale, exchange or transfer of a mortgage loan or participation interest by a plan prior to the maturity date of the instrument whether or not acquired pursuant to the exemption.

Included among the conditions set forth in PTE 82-87 is the requirement that a decision to issue a mortgage commitment be made on behalf of the plan by a qualified real estate manager which is independent of the plan. In addition, the financing for residential dwelling units to be purchased must be provided through an established mortgage lender. The lender must be independent of the plan and be engaged in making or purchasing mortgage investments in the normal course of business. The lender must also (1) have approval from the Department of Housing and Urban Development (HUD) to participate in mortgage insurance programs under the National Housing Act; (2) have been approved to act as a seller/servicer for programs sponsored by the Federal Home Loan Mortgage Corporation (FHLMC) or Federal National Mortgage Association (FNMA); or (3) by a State housing agency or independent State authority.

Loan transactions eligible for relief under the exemption are mortgage loans on residential dwellings of one to four units which, at origination, were eligible for purchase through an established program by the FHLMC, FNMA, or Government National Mortgage Association (GNMA). The terms of any loan or commitment must be at arm's length, that is, at least as favorable to the plan as would be the terms of similar agreements between unrelated parties.

PTE 82-87 provides limited relief from ERISA's Code and non-Code prohibited transaction provisions. The exemption requires that decisions regarding plan investments (including investments in residential mortgages) must be made by appropriate plan fiduciaries, and must be consistent with the requirement that the plan be for the exclusive benefit of employees and their beneficiaries, the prudence rules governing plan investments, and ERISA's other fiduciary standards.

Issue

The issue is whether certain mortgage transactions between an employee benefit plan and a party-in-interest (or a disqualified person) shouldbe exempted from ERISA's prohibited transactions of ERISA.

Explanation of the bill

The bill would exempt qualified mortgage transactions from the prohibited transaction standards of ERISA. Qualified mortgage transactions generally include those transactions described in PTE 82-87. However, the bill would also exempt from the prohibited transaction rules (1) the servicing of a residential mortgage loan (or a participation interest therein) by an employee benefit plan, including (but not limited to) collecting mortgage payments, assuring that taxes and insurance premiums for the residential dwelling units are paid, and making decisions relating to, and handling, foreclosures; (2) the purchase or sale, or commitment to purchase or sell an interest in a pool consisting solely of residential mortgage loans, but only if conducted in accordance with the practices customary in the residential mortgage industry; (3) the formation and operation by one or more employee benefit plans of a pool or pools of residential mortgage loans; or (4) the purchase or sale, or commitment to purchase or sell a mortgage-backed security.

For purposes of the bill, a residential mortgage pool is an aggregation of funds or residential mortgage loans aggregated for the purpose of investment by one or more employee benefit plans, pursuant to terms and conditions customary in the residential mortgage industry. A mortgage-backed security is defined in the bill as a certificate representina a fractional undivided interest in a mortgage pool, or a participation in a mortgage pool, which is held in trust and is secured by mortgages or deeds of trust on residential property, including undistributed cash and property which had secured such obligaticns and has been acquired by foreclosure.

Under the bill, a qualified mortgage transaction is exempted from ERISA's prohibited transaction provisions if the transaction is at arm's length. For this purpose, arm's length means in accordance with customary practices in the residential mortgage industry.

The bill's exemption for residential mortgage loans includes mortgages on structures consisting of two or more residential dwelling units.

The bill's provisions would supersede any State laws relating to qualified mortgage transactions engaged in by employee benefit plans.

Effective date

The bill would take effect upon enactment.

Revenue effect

The bill would be expected to have a negligible impact on revenue.

chafee news

John H. Chafee
U.S. Senator
for Rhode Island
5229 Dirksen Building
Washington, D.C. 20510

For Release at 2:30 P.M.
Monday, September 27, 1982

For Further Information:
Cleve Corlett (202) 224-6167

CHAFEE URGES ACTION ON BILL ALLOWING MORTGAGE INVESTMENTS BY PRIVATE PENSION FUNDS

WASHINGTON -- Senator John H Chafee (R-R.I.) today opened hearings before a Senate Finance Subcommittee on legislation he has introduced to ease restrictions which make it difficult for managers of private pension plans to invest their funds in mortgage portfolios.

The legislation has attracted widespread support in both the Senate, where nine of his colleagues have cosponsored it, and in the House, where nearly half of the membership has supported a similar measure.

Chafee indicated today he is willing to modify the measure if necessary to attract support from not only the housing industry, but also from pension managers and the Administration. Chafee said he hopes the Administration will take a position on the bill soon, perhaps offering its own version.

The Rhode Island Senator, who is chairman of the Senate Finance Subcommittee on Savings, Pensions and Investment Policy -- before which the hearing was held -- made it clear the objective of the bill is to make it possible for money from pension funds to be used for housing investments. "It does not by any means require pension funds to put their money into home mortgages, not is it intended to make investments at below market rates."

But, he said, future demands for mortgage funds for housing will not likely be satisfied by traditional sources of financing -- savings and loan associations. "The mortgage market is undergoing dramatic change... Congress should do everything in its power to assure that, as changes occur, barriers are removed to the free flow of investor dollars into the housing market."

Chafee said one modification in the bill might be necessary to make clear that the legislation is not intended to "open the way for pension funds to engage directly in making individual mortgage loans as would a savings and loan or mortgage company."

"My primary purpose in any legislation...is that benefits promised to workers and retirees be protected," he said, while allowing an "open door" for development of a private sector secondary market for mortgage investments."

STATEMENT OF SENATOR DOLE

HEARING ON S. 2232, S. 2860, AND S. 2918

MR. CHAIRMAN, I WOULD LIKE TO WELCOME MR. EDWARD S. RISS, PRESIDENT OF REPUBLIC INDUSTRIES, INC., WHO IS HERE TO TESTIFY ON S. 2860. REPUBLIC INDUSTRIES, INC. IS A PRIVATELY OWNED HOLDING COMPANY, HEADQUARTERED IN KANSAS CITY, MISSOURI. MR. RISS' TESTIMONY SHOULD BE VERY IMPORTANT TO THE SUBCOMMITTEE BECAUSE HIS COMPANY IS SUBJECT TO A WITHDRAWAL LIABILITY CLAIM OF APPROXIMATELY $20 MILLION, EVEN THOUGH THE ACQUISITION GIVING RISE TO THE CLAIM OCCURRED BEFORE ENACTMENT OF THE MULTIEMPLOYER PENSION PLAN AMENDMENTS ACT OF 1980. MR. RISS, I WELCOME YOU BEFORE THE SUBCOMMITTEE AND I LOOK FORWARD TO YOUR TESTIMONY ON THIS VERY IMPORTANT SUBJECT.

THE SUBCOMMITTEE WILL ALSO HEAR TESTIMONY ON S. 2232 AND S. 2918.

S. 2232

UNDER PRESENT LAW, A LUMP SUM DISTRIBUTION TO AN EMPLOYEE FROM A QUALIFIED PLAN WHICH IS ROLLED OVER WITHIN 60 DAYS TO ANOTHER QUALIFIED PLAN OR TO AN INDIVIDUAL RETIREMENT ACCOUNT IS TREATED AS A TAX FREE DISTRIBUTION. IN ORDER TO QUALIFY FOR THIS TREATMENT, THE LUMP SUM DISTRIBUTION MUST CONSIST OF THE ENTIRE BALANCE OF CREDIT TO THE EMPLOYEE UNDER THE PLAN AND THE DISTRIBUTION MUST BE MADE WITHIN ONE TAXABLE YEAR.

S. 2232 WOULD PROVIDE A SPECIAL EXCLUSION FROM GROSS INCOME OF QUALIFIED PLAN DISTRIBUTIONS THAT WERE MADE WITHIN TWO CALENDAR YEARS AND ROLLED OVER INTO AN INDIVIDUAL RETIREMENT ACCOUNT.

S. 2918

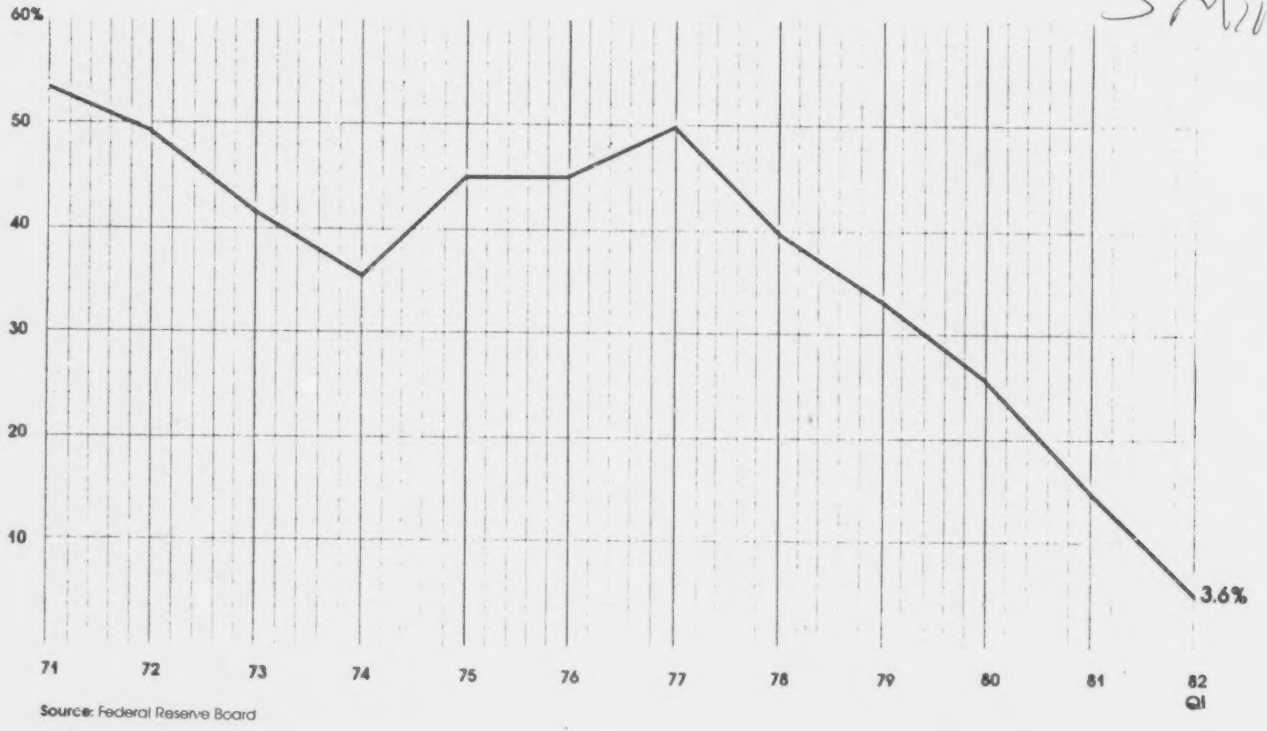
UNDER PRESENT LAW, A PLAN IS PERMITTED TO MAKE MORTGAGE COMMITMENTS AND LOANS ON RESIDENTIAL DWELLINGS, WHICH MIGHT OTHERWISE CONSTITUTE A PROHIBITED TRANSACTION, IF CERTAIN CONDITIONS ARE MET. THESE LOANS MUST BE CONSISTENT WITH ERISA'S PRUDENT MAN STANDARDS FOR PLAN INVESTMENTS AS WELL AS THE ACT'S OTHER FIDUCIARY STANDARDS.

S. 2918 WOULD EXEMPT QUALIFIED MORTGAGE TRANSACTIONS FROM THE PROHIBITED TRANSACTION RULE IF THE TRANSACTION IS IN ACCORDANCE WITH CUSTOMARY PRACTICES IN THE RESIDENTIAL MORTGAGE INDUSTRY. IN ADDITION, S. 2918 WOULD SUPERCEDE ANY STATE LAWS RELATING TO QUALIFIED MORTGAGE TRANSACTIONS ENGAGED IN BY EMPLOYEE BENEFIT PLANS.

MR. CHAIRMAN, I LOOK FORWARD TO HEARING THE TESTIMONY OF ALL WITNESSES ON THESE IMPORTANT BILLS. I WOULD ALSO LIKE TO ACKNOWLEDGE YOUR WORK IN THE PENSION REFORM AREA, ESPECIALLY ON THE EXEMPTION FOR QUALIFIED MORTGAGE TRASACTIONS. YOU HAVE DILIGENTLY WORKED TO IMPROVE OUR PENSION LAWS, AND I LOOK FORWARD TO WORKING WITH YOU AGAIN ON THESE VERY IMPORTANT ISSUES.

Percent Share of Total Mortgage Funds Advanced by Savings Institutions, 1970—1982

E. Smith



Source: Federal Reserve Board

STATEMENT BY SENATOR GEORGE J. MITCHELL
BEFORE THE SENATE FINANCE COMMITTEE
IN SUPPORT OF S. 2918.
THE RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1982
SEPTEMBER 27, 1982

Mr. Chairman, I want to express my support for S. 2918, the Residential Mortgage Investment Act of 1982, which you introduced eleven days ago. I am pleased that the Subcommittee on Savings, Pensions and Investment Policy has scheduled a hearing so we can air this proposal to make more competitive investments in residential mortgages by pension plans.

I speak today as a cosponsor of the legislation and as one who is supportive of measures to help the housing industry which has been devastated for nearly four years by a virtual depression.

A look at the latest statistics underscores the plight of the industry. Annual housing starts have dropped from 2 million in 1978 to 1.1 million last year. Starts during the first 8 months of this year have run at a level that is 18% below that for 1981, suggesting that housing production could drop to an all-time low in the post-war era.

The decline in production has meant a surge in bankruptcies for building firms and subcontractors, and a rise in the industry's unemployment rate. In August, 1982, the construction trades experienced a 20.3% unemployment rate, with over 1 million individuals out of work. That means one of every ten persons unemployed in this country comes from the building trades.

High interest rates have been the principal factor behind the downturn in the housing industry, placing homeownership beyond the reach of most Americans. At the same time, the traditional source of mortgage credit, the savings and loan industry, is going through a difficult period. Statistics gathered by the Federal Reserve Board show that in 1971, savings institutions provided 53% of total mortgage funds advanced. Today, that share has dropped to an astonishing 3.6%.

We must therefore look to other sources of capital to satisfy the demand for mortgage credit in the 1980's. That demand has been pent up during the last few years as interest rates have remained prohibitively high. First-time home buyers among the baby boom generation could require as much as $200 billion a year in mortgage money, according to some analysts.

The Residential Mortgage Investment Act of 1982 gives us an opportunity to tap a source of funds that has so far invested only 3% of its assets in residential and commercial mortgages. The $600 billion in public and private pensions represent a credit potential that cannot be ignored. According to testimony recently presented to this committee, pension funds have not invested in housing because mortgages have not been packaged as attractively as other securities. Further, pension funds have had to overcome barriers imposed by the Employee Retirement Income Security Act (ERISA) that have made mortgages in effect an inferior class of investment.

While the Labor Department has attempted to ease ERISA restrictions on mortgage lending, the changes have been insufficient to have any salutary effect. S. 2918 is intended to remedy that problem by exempting certain qualified mortgage transactions enumerated in the bill from the prohibited transactions provisions of ERISA, from the Internal Revenue Code of 1954, and from any contrary provisions of state law. Such transactions would still have to meet the prudence and self-dealing provisions of ERISA, however, ensuring that pension managers would only invest in mortgages that are sound, provide a good yield and constitute arm's length transactions.

Mr. Chairman, this legislation is an extremely important measure for the housing industry. It may not be a panacea for the problems facing it today, but it offers new hope for a source of mortgage capital which could in the long run ease the pressure on interest rates.

Perhaps its best feature is that it does not require the expenditure of public funds. By enacting this bill into law, we would not be creating a new federal program. Rather, we would be removing some of the impediments that now discourage pension plans from investing their assets in mortgages and mortgage-backed securities.

Mr. Chairman, I applaud your leadership in introducing this legislation and in chairing this hearing for the presentation of testimony. I need not remind anyone that little has been done this year to aid the housing industry. This is one measure which would provide assistance and at no cost to the taxpayers. I urge this committee, and indeed the full Senate, to act upon it before adjournment.

Senator CHAFEE. Good afternoon, ladies and gentlemen. We have a hearing this afternoon on three measures. The list here carries the three measures—S. 2232, S. 2860, and S. 2918, which deals with pension plan investments in the residential mortgage market.

Senator Dole, we are delighted you are here—the distinguished chairman of the full committee. And I presume that your comments will be in connection with the pension plan investments.

Senator DOLE. I believe all of the bills on today's agenda are meritorious. In addition, Mr. Riss is going to be testifying on 2860, Senator Danforth's bill.

Senator CHAFEE. Why don't we start with that panel first, then. If that panel would come up. Is everybody here from that panel? Mr. Riss from Republic Industries, Kansas City; Joe A. Masterson, chairman and chief executive officer, Terson, Chicago, Ill.; and Peter Turza, counsel.

Now if you gentlemen could identify yourselves. Which is Mr. Riss?

Mr. Chairman, I guess we have had a late change. It is Mr. Riss, Mr. Anderson? Who do we have?

Mr. MASTERSON. This is Mr. Masterson.

Senator CHAFEE. Mr. Masterson. All right.

Mr. WILKINSON. Mr. Wilkinson.

Senator CHAFEE. All right. You are Mr. Wilkinson.

Mr. TURZA. Wilkinson and Turza are for Associated Specialty Contractors.

Senator CHAFEE. OK. And Mr. Riss is in the middle.

Mr. RISS. Yes, sir.

Senator CHAFEE. All right. Go ahead, Mr. Chairman.

Senator DOLE. Could I just say a word? I want to thank you, Mr. Chairman, for having the hearings on this proposal as well as two others that I think are meritorious.

Mr. Riss, who is president of Republic Industries, is here to testify on S. 2860. Republic Industries is a privately owned holding company headquartered in Kansas City, Mo. His testimony should be very important to the subcommittee because his company is subject to withdrawal liability claims of approximately $20 million even though the acquisition giving rise to the claim occurred before enactment of Multiemployer Pension Plan Amendments Act of 1980. So on behalf of Senator Danforth and myself I welcome not only Mr. Riss, but the other members of the panel who will testify on this measure.

Senator CHAFEE. Well, thank you very much, Mr. Chairman, for those comments. And I know that the testimony these witnesses are going to give on S. 2860 affects other companies far beyond their own—companies that I'm familiar with myself that had a problem.

So why don't we start off as listed here. Mr. Riss, why don't you lead off? Let's see, do we have copies of the testimonies here?

Senator DOLE. Yes.

Senator CHAFEE. All right, go ahead, Mr. Riss.

STATEMENT OF EDWARD RISS, PRESIDENT, REPUBLIC INDUSTRIES, KANSAS CITY, MO.

Mr. RISS. Mr. Chairman, I would like to thank you and also Senator Dole for being with us and for listening to my comments today. I would also thank the committee for allowing me the opportunity to testify before it.

It is my purpose today to give this committee some insight into what has happened to a firm already in receipt of astronomical liability claims brought about by the retroactive application of the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980.

Republic Industries is a privately owned holding company headquartered in Kansas City. On May 4, 1978, Republic entered into contracts to purchase Johnson Motor Lines. Johnson was a contributor to a number of multiemployer pension plans. Precontract analysis of the proposed investment involved, among other things, an analysis of Johnson's audited financial statements. The same, very well respected Big Eight accounting firm which audited and certified Johnson's financial statements as of December 31, 1977, also audited Republic statements and those of the Central States Southeast and Southwest Areas Pension Fund during this same period. There was no mention, either on Johnson's balance sheet or in footnote form of any withdrawal liability, potential or otherwise, to the Central States Fund or to any of the other pension funds to which Johnson was a contributor.

Additionally, the labor contracts and pension plan participation agreements to which Johnson was a signatory and under which Johnson was obligated to make payments to the various plans were reviewed prior to the acquisition. These contracts specifically limit Johnson's liability to those plans to the contribution per man-hours specified in those contracts and agreements.

During the ensuing time period after the acquisition, the advent of motor carrier deregulation, surging interest rates, and a general rate level labor cost imbalance threatened the liability of Johnson and other carriers in similar situations. After reviewing and exhausting a number of alternatives, Johnson had little choice but to announce on July 30, 1980, that it would close its doors and not accept shipments from customers after August 8 of that year.

From that point on, the orderly liquidation of Johnson proceeded, involving primarily an auction of parts and equipment and the sale of real estate. The proceeds of those activities were utilized to fully satisfy all of Johnson's known obligations and liabilities in a fair, orderly and timely fashion. Additionally, all of Republic's banking debts associated with the Johnson acquisition has been fully repaid.

As you know, Congress sent the Multiemployer Pension Plan Amendments Act of 1980 to President Carter on September 19 of that year, and it was signed by the President on September 26—nearly 2 months after Johnson elected to cease operation. Its provisions for withdrawal liability—applied after the fact—have resulted in claims totaling nearly $20 million being filed against Johnson by the various pension plans to which Johnson was a contributing employer. At no time before or after July 30, 1980, until early Octo-

ber of that year when Johnson received a letter from Central States reporting its intent to make a claim under the act did any officer or director of Republic, or to the best of my knowledge any officer or director of Johnson, have any knowledge of the act, its withdrawal liability provisions or any indication that Johnson might have any liability to Central States or any other multiemployer pension plan, other than the contractual liability mentioned earlier.

Yet, Republic, as a result of its acquisition of Johnson, is saddled with withdrawal liability claims imposed retroactively upon it, and totaling nearly $20 million, after having purchased Johnson some time before for $16,800,000. The aggregate $20 million claim figure exceeds not only the purchase price paid for Johnson, but also exceeds Johnson's net worth; it exceeds the cumulative net earnings of Johnson since its inception in 1945; and it, indeed, exceeds the net worth of Republic Industries itself.

The incredible prospect of our making a lump sum payment of our aggregate liability claim is mind boggling. The act also provides an equally onerous formula for determining the amount and number of payments required to pay off the liability on an installment basis. Under the formula, our annualized payments to various plans would approach $4 million a year, for a period in excess of 6 years. This yearly amount greatly exceeds the payments made by Johnson to the plans during any of its years of full operation.

To protect ourselves against this onslaught of potential liability, we are currently involved in litigation in four separate Federal district courts in which we challenge the constitutionality of the statute, particularly as it is retroactively applied to Johnson. Our legal and actuarial fees already exceed a half million dollars, and will surely increase as the wave of litigation continues.

Additionally, and very important also, we live continually with the ominous possibility of an adverse court decision at any moment, triggering the payments I just described. We simply do not have a great deal of time. That's why time is of the essence in this matter.

Senate bill 2860, as written, should be enacted immediately to eliminate the retroactive imposition of the withdrawal liability provisions of the act. There is, indeed, judicial footing—sound footing—for such an enactment since there have been some Federal court decisions to date which had declared the retroactive application of those provisions to be unconstitutional.

I want to take this opportunity, again, to thank you very much for allowing me to testify. And to again emphasize that in our situation time is of the essence.

Thank you very much.

Senator CHAFEE. Well, thank you very much, Mr. Riss.

[The prepared statement of Edward S. Riss follows:]

TESTIMONY OF EDWARD S. RISS

PRESIDENT, REPUBLIC INDUSTRIES, INC.

S. 2860

BEFORE THE SUBCOMMITTEE ON

SAVINGS, PENSIONS, AND INVESTMENT POLICY

SENATE FINANCE COMMITTEE

WASHINGTON, D. C.

My name is Edward S. Riss, and I serve as the President of Republic Industries, Inc. I would like to thank the Committee for allowing me the opportunity to testify before it this morning.

It is my purpose today to give this Committee some insight into what has happened to a firm already in receipt of astronomical liability claims brought about by the retroactive application of the withdrawal liability provisions of the Multi-Employer Pension Plan Amendments Act of 1980. Perhaps the cruelest feature of this legislation, as it applies to us, is that this liability did not exist at the time of our subsidiary's withdrawal from any pension plan. It was instead created later and applied retroactively to it and other firms going out of business during the same period. This, of course, effectively denied us the opportunity to seek any other alternative which might have precluded its imposition.

Additionally, the Act seeks to satisfy this liability, not only by seizing the assets of the entity ceasing operation, but also by seizing the assets of any and all entities within a "controlled group" of corporations, as defined in the Internal Revenue Code. In our situation, these other corporations operated independent of the withdrawing entity, were in existence prior to Republic's purchase of that entity, and are not now participating in any of the business handled by the entity prior to its cessation of operation.

BACKGROUND HISTORICAL INFORMATION

Republic Industries, Inc. is a privately owned holding company, headquartered in Kansas City, Missouri. On May 4, 1978, Republic entered into contracts to purchase Johnson Motor Lines, Inc.

Johnson was a large motor carrier, operating along the Eastern Seaboard from New England into the Carolinas and Georgia, then through the Gulf states into Texas. Johnson was a contributor to a number of multi-employer pension plans.

The purchase contracts specified that the purchase price paid by Republic to the stockholders of Johnson would be the net book value per share of Johnson, as reflected in audited statements of December 31, 1977. The same, very well-respected Big Eight accounting firm which audited and certified Johnson's statements as of that date also audited Republic's statements and those of the Central States Southeast and Southwest Areas Pension Fund. There was no mention, either on Johnson's balance sheet or in footnote form of any withdrawal liability -- potential or otherwise -- to the Central States Fund or to any of the other pension funds to which Johnson was a contributor.

Additionally, the labor contracts and pension plan participation agreements to which Johnson was a signatory and under which Johnson was obligated to make payments to the various plans were reviewed prior to the acquisition. These contracts specifically limit Johnson's liability to those plans to the amounts per man-hour specified in those contracts and agreements.

On March 16, 1979, the Interstate Commerce Commission approved Republic's application for permission to acquire and control Johnson. On June 14, 1979, Republic acquired and assumed control of Johnson for a purchase price of approximately $16,800,000.

During the following year, the advent of motor carrier deregulation, surging interest rates and a general rate level/labor cost imbalance threatened the viability of Johnson and other carriers in similar situations. After reviewing and exhausting a number of alternatives, Johnson had little choice but to announce on July 30, 1980, that it would close its doors and not accept shipments from customers after August 8, 1980.

From that point, the orderly liquidation of Johnson proceeded, involving primarily an auction of parts and equipment and the sale of real estate. The proceeds of those activities were utilized to fully satisfy all of Johnson's known obligations and liabilities in a fair, orderly and timely fashion.

Additionally, all of Republic's banking debt associated with the Johnson acquisition has been fully repaid.

ECONOMIC IMPACT

As you know, Congress sent the Multi-Employer Pension Plan Amendments Act of 1980 to President Carter on September 19th of that year, and it was signed by the President on September 26th -- nearly two months after Johnson elected to cease operation. Its provisions for withdrawal liability -- applied after the fact -- have resulted in the following claims being filed against Johnson by the various pension plans to which Johnson was a contributing employer:

NAME OF PENSION FUND FILING CLAIM	DATE CLAIM RECEIVED	AMOUNT OF CLAIM
Central States, Southeast and Southwest Areas Pension Fund	7/1/81	$16,658,936.94
New England Teamsters and Trucking Industry Pension Fund	8/21/81	1,402,961.00

NAME OF PENSION FUND FILING CLAIM	DATE CLAIM RECEIVED	AMOUNT OF CLAIM
Central Pennsylvania Teamsters Pension Fund	11/23/81	$ 848,494.00
Trucking Employees of North Jersey Local 560 Pension Fund	1/29/81	599,112.50
Teamsters Council No. 83 of Virginia Pension Fund	7/7/81	189,107.00
TOTAL		$19,698,611.44

At no time -- before or after July 30, 1980 -- until October of that year, when Johnson received a letter from Central States reporting its intent to make a claim under the Act, did any officer or director of Republic, or to the best of my knowledge, any officer or director of Johnson, have any knowledge of the Act, its withdrawal liability provisions, or any indication that Johnson might have any liability to Central States or any other multi-employer pension plan, other than the contractual liability mentioned earlier.

Yet, Republic, as a result of its acquisition of Johnson, is saddled with withdrawal liability claims imposed retroactively upon it, and totalling nearly $20,000,000, after having purchased Johnson some 14 months before for $16,800,000. The aggregate claim figure exceeds:

A. The purchase price paid for Johnson.

B. Johnson's net worth.

C. The cumulative net earnings of Johnson since its inception in 1945.

D. The net worth of Republic Industries, itself.

The incredible prospect of our making a lump sum payment of our aggregate claim liability is mind boggling. The Act also provides an equally ludicrous

formula for determining the amount and number of payments required to pay off the liability on an installment basis. Under the formula, our annualized payments to the various plans would approach $4,000,000 a year, for a period in excess of six years. This yearly amount greatly exceeds the payments made by Johnson to the plans during any of its years of full operation.

To accentuate the problem, the Act requires that these payments begin within 30 to 60 days after receipt of a claim from a plan. Failure to make any of the installment payments results in the immediate acceleration of the entire liability.

To protect ourselves against this onslaught, we are currently involved in litigation in four separate Federal District Courts, in which we challenge the constitutionality of the statute, particularly as it is retroactively applied to Johnson. Ours was the first of over one hundred twenty-five lawsuits that have been filed and raise similar issues of constitutionality. Our legal and actuarial fees already exceed one-half million dollars, and will surely increase as the wave of litigation continues.

PROPOSAL FOR A LEGISLATIVE REMEDY

Legislation should be enacted immediately to eliminate the retroactive imposition of the provisions of the Act. The financial impact of the withdrawal liability provisions is so devastating that the negative ramifications of imposition of the liability, retroactively or otherwise, far outweigh any positive benefit to the plans therefrom.

Senator CHAFEE. To say that this is a troublesome problem is somewhat of an understatement.

Mr. RISS. Yes, Senator, it is.

Senator CHAFEE. It's no laughing matter. The whole business of having a claim that is greater than, as you say, the purchase price paid for the company—the company's net worth, accumulative net earnings of Johnson since its inception in 1945. Is that right?

Mr. RISS. That's correct, Senator.

Senator CHAFEE. Thirty-five years of operation. And it's greater than the net of Republic Industries itself. Well, I think you make a pretty good case here. And I know that Senator Danforth is extremely interested in it and concerned about the situation that has arisen there. So we will do our best to straighten it out. And we also will bear in mind your admonition that time is of the essence.

Senator Dole, do you have any questions that you would like to ask?

Senator DOLE. I guess the $64,000 question is if we can agree on doing what will be suggested by the panelist—if we can do it quickly enough to be of any benefit. We have been informed that this may be the last week of this session of Congress until late November. When we come back in November, I assume the session will be limited to appropriations and some other general issues. So there is still a chance to act this week. Have you had any luck on the House side?

Mr. RISS. The appropriate House committees have been informed about S. 2860.

Senator CHAFEE. Your concern is that some court decision will come down in the interim. How far have you gotten in these law suits?

Mr. RISS. Senator, we have, in certain instances, been able to obtain temporary restraining orders and preliminary injunctions. However, in a number of the cases we feel that decisions on the merits will be forthcoming momentarily. If those decisions are adverse, it's our feeling that the plans will then probably be forced to comply with the statute.

Senator CHAFEE. Well, you will have a little trouble complying with it, I guess.

Mr. RISS. We would be unable to comply with it.

Senator CHAFEE. All right. Other questions may come up as we proceed with the other witnesses.

Mr. Anderson? Oh, he didn't show. Mr. Masterson.

STATEMENT OF JOE A. MASTERSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, TERSON, INC., CHICAGO, ILL.

Mr. MASTERSON. Thank you, Senator. On behalf of the more than 1,500 employees of the Terson Co., I am pleased to be able to be here today to bring to your attention some specific instances as it relates to our company, which are not terribly different from what you just heard. The numbers are different, but the circumstances tend to be relatively the same.

Our company—the Terson Co.—is a holding company made up of a group of diversified food companies scattered around the United States. Among them was a food company engaged in the commer-

cial baking business. As a member of the commercial baking industry, we participated in the multiemployer pension plans to the bakers and confectioners unions and the Teamsters Union. A decision was made some time ago—back in the late 1970's—to withdraw from the baking business because it had become a very impossible business, and was incurring substantial losses on behalf of the Terson Co., and its predecessor, Ward Foods. And during that consideration period, there was obviously no knowledge of the MPPAA legislation or its potential impact. And, unfortunately, a decision was entered into during 1980 for the termination of the two remaining baking operations—one in New Jersey and one in Chicago—during the time when the MPPAA legislation was being created. Those decisions were not decisions that were entered into either quickly or without a good deal of strategic consideration. They were also not decisions that could either be accelerated in order to avoid potential MPPAA liabilities, et cetera. They were organized and what I hope and believe in time will prove to be considered business decisions that were required to be effected in October and December 1980.

However, with the implementation of the divestitures, and in both cases at least portions of the businesses were sold as going concerns, and a certain part of the businesses were liquidated, these MPPAA liabilities were imposed upon the company. We have several law suits currently pending, one of which is in excess of $3½ million by the Interstate Pension Fund. That relates to the Chicago bakery sale for which we received $1½ million in cash, all of which was used to pay obligations; none of which was retained by the company. But it was required to be used in the divestiture of that business. And yet we now have a $3½ million claim. We have several other claims that with the passage of time could also become significant liabilities. It has required us to qualify our financial statements. It has created problems with our trade creditors and our suppliers. And, quite frankly, I think it has the possibility of jeopardizing the jobs of the 1,500-plus employees who I represent here today.

The claims, either outstanding and/or to become outstanding with the passage of time under the current legislation, would be substantially in excess of our company's net worth, and would create additional financial hardships on us.

We would like to take the proposal by Mr. Riss a bit further. We believe that the concept of retroactivity is substantially onerous, and based on past legislation enactments, somewhat unusual. And we would like to see the effect of it phased in over a period of time, and at the earliest, no earlier than January 1, 1981.

We also are involved in attempting to support modifications in the original MPPA Act of 1980. We have given testimony in Senator Hatch's committee, and we will be an active supporter in the future.

Thank you very much for your time.

Senator CHAFEE. Well, thank you very much.

[The prepared statement of Joe A. Masterson follows:]

STATEMENT OF JOE A. MASTERSON
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER
OF
THE TERSON COMPANY, INC. AND
TERSON HOLDINGS, LTD.

TO

FINANCE SUBCOMMITTEE ON SAVINGS, PENSION, AND INVESTMENT POLICY SETS HEARING ON MODIFICATION TO THE MULTIEMPLOYER PENSION PLAN AMENDMENTS ACT OF 1980 AND PENSION PLAN INVESTMENTS IN THE RESIDENTIAL MORTGAGE MARKET

RELATING TO S. 2860

ON SEPTEMBER 27, 1982

The Terson Company, Inc. ("Terson") is a corporation organized under the laws of the State of New York with its principal offices and headquarters in Chicago, Illinois and operations in Pennsylvania, Wisconsin, New York, Michigan and Illinois. Terson, formerly known as Ward Foods, Inc., has since the 1870's been engaged in the baking and other foods processing businesses. Among our well known products are Chunky Chocolate and Superior Potato Chips.

The imposition of withdrawal liability as mandated by the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA") has had a devastating impact on Terson. I will not review the harsh impact MPPAA has visited on employers and unions and the 100 plus lawsuits outstanding challenging that Act and its constitutionality, because you are well aware of those and that the proposed amendment would ameliorate some of the harsh transitional burdens imposed by MPPAA. I, however, would appreciate the opportunity to inform you of the effect this

legislation has had on Terson and why the proposed amendment is so vital to Terson.

Prior to September 1980, it was decided, as a matter of long range corporate policy, that the future of the Company and its employees required the divestiture of certain operations of the Company. The divestiture and consolidation program, was initiated and put into irreversible course during 1979 and 1980. In early October of 1980, the Company's bakery operation in East Orange, New Jersey was closed. This operation contributed to five separate multiemployer plans and because of the requirements of MPPAA, passed only days before the closing of the New Jersey plant, Terson has received demands from two plans for payment of withdrawal liability aggregating $1,673,958 and requiring monthly payments of $65,913.25 to be made by Terson to the pension funds.

In December of 1980, Terson sold the assets of its Chicago bakery operations for $1,500,000 to Interstate Brands Corporation. This transaction has resulted in the demand by 2 multiemployer plans upon Terson to pay withdrawal liability in installments over an eight year period totalling $3,484,713. This amount represents more than twice the amount the Company realized from the sale of its assets, and approximately 3/4 of Terson's net worth. The entire net worth of the Company at March 21, 1981, the time of the demand of this liability, was $4,729,000. The liability asserted is almost $1,000,000 more than the Company contributed to the pension fund during the entire preceding 10 year period.

These two difficult business decisions made by Terson were necessary for the long-term health of the company. When the decisions were made and the process for carrying them out was begun, there was no reason to believe that a MPPAA liability of this magnitude would result. At the time it was unreasonable to expect that some phase-in period for the new law would be enacted. This had been the experience with the passage of ERISA in 1974.

As you know, MPPAA amended the Employee Retirement Income Security Act of 1974 ("ERISA"). ERISA was the first comprehensive attempt by the Congress to regulate all aspects of pension plans, although pre-ERISA regulation was carried out under various provisions of the Internal Revenue Code, the Labor-Management Regulations Act of 1947, and the Welfare and Pension Plans Disclosure Act of 1958. When ERISA was enacted, it generally permitted a phase-in of the effective date of its many provisions. The minimum participation and vesting standards of Title I of ERISA were to be effective with respect to existing plans on January 1, 1976. The prohibited transaction rules were generally not immediately effective on transactions where binding contracts or commitments were already existing between plans and party-in-interest. Title IV of ERISA which generally established the system of single employee plan termination insurance was, however, effective with the date of enactment, subject to phase-in provisions.

On behalf of Terson, I support S. 2860 in its attempt to mitigate the harsh and devastating retroactive effects of

MPPAA. I, however, would like to suggest that some further change in the date is appropriate. This appears to be the direction set by the courts in two cases dealing with the issue of effective dates of similar pension legislation. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, in Nachman Corporation v. PBGC, 592 F.2d 947 (7th Cir. 1979) affirmed. The courts have made it clear that when statutes governing pension plans are changed creating substantial unforeseen new liabilities, that there should be a phase-in of the application of the law to avoid unfair and unreasonable economic results. In the ERISA legislation there was almost a 9 month phase-in period after enactment until the end of May 1975 to give employers a chance to review their plans and to terminate or continue their plans under the new statutory scheme.

MPPAA fails to meet the constitutional standards set by the United States Supreme Court in that it not only failed to provide for a prospective phase-in period, but it established a retroactive effective date. In Nachman, in which the constitutionality of pre-MPPAA, ERISA was upheld by the Seventh Circuit Court of Appeals against a due process (reasonableness) challenge, the court evaluated the burden imposed on employers by analyzing four factors:

1. the reliance interests of the parties;
2. whether the private interest being impaired is in an area that has been subject to regulatory control in the past;

3. the equities of imposing the legislative burdens; and

4. the inclusion of statutory provisions designed to limit and moderate the impact of the statutory burden.

The Supreme Court had previously recognized that the funding of pension plans is "an area where the element of reliance [is] vital" to the employer. Allied Structural Steel v. Spannaus, at 234, 246. The Court also stated that:

> [Pension] plans, like other forms of insurance, depend on the accumulation of large sums to cover contingencies. The amounts set aside are determined by a painstaking assessment of the insurer's likely liability. Risks that the insurer foresees will be included in the calculation of liability, and the rates or contributions charged will reflect that calculation. The occurrence of major unforeseen contingencies, however, jeopardizes the insurer's solvency and, ultimately, the insureds' benefits. Drastic changes in the legal rules governing pension and insurance funds, like other unforeseen events, can have this effect.

Los Angeles Dept. of Water & Power v. Manhart, 435 U.S. 702, 721 (Emphasis added).

Applying these legal standards to the Terson situation, the Committee can see that the contract impairment by MPPAA was simply not an "actual, measurable cost" to us because the reasonable exception was, and is, that the plans are not about to terminate and do not even need the funding, according to the conservative assumptions of the plan actuaries. Moreover, normal funding of such plans will be an "actual, measurable cost" of those employers who continue in the industry to bargain with the

respective unions and who continue to sell products made by their employees/participants and to pass along the cost of such to purchasers of the products.

Unlike the situation in Nachman, participants of most multiemployer plans are not faced with termination of an unfunded plan. Unlike Nachman, employers in multiemployer plans are not abandoning their employees. Unlike Nachman, the employer and the union bargained for the status quo, not the unexpected, unlimited and potentially economical destruction liability imposed by MPPAA. Unlike Nachman, multiemployer plans are by their nature ongoing plans where when one employer withdraws, usually another takes its place or the work force of existing employers expand.

Finally, the Nachman opinion gave decisive weight to those ERISA provisions designed to moderate the impact of the termination liability wherein it stated:

> Perhaps the most important facts distinguishing ERISA from the Minnesota statute in Allied Structural Steel are those revealing the Congressional attempt to moderate the impact of the liability imposed. Title IV provisions represent a rational attempt to impose liability only to the extent necessary to achieve the legislative purpose. Congress concluded that it was necessary to insure unfunded vested benefits and established a federal corporation for that purpose. However, it was also determined that it would not be possible to maintain an effective insurance program without imposing some liability on employers. The abuses employer liability was designed to cure included terminations motivated by a desire to avoid the continued burden of funding. III Legislative History at 4741 (remarks of Sen. Williams); II Legislative History at 3382 (remarks of Rep. Gaydos). Congress was also concerned that without the risk of liability, employers might use promises of higher retirement benefits for bargaining leverage, knowing that the PBGC would be required to fulfill the promise. S.Rep.No. 93-383, I Legislative History at 1155. It was also

> believed that to impose liability would cause employers to assume a more responsible funding schedule. II Legislative History at 1873 (remarks of Sen. Griffin). These first two considerations would not have been relevant in the Minnesota scheme because no agency was established to assume primary responsibility for the payment of benefits.
>
> Acknowledging that employers on the verge of bankruptcy would be unlikely to terminate pension plans solely to take advantage of termination insurance, Congress provided net worth limitations on the amount of potential liability. 29 U.S.C. §1362. Congress also devised other provisions to temper the burdens imposed. Employers will not necessarily be liable for the full amount of benefits promised in the plan, since Congress set a level on the amount of benefits guaranteed. 29 U.S.C. §1322(b)(3). In Section 1323 Congress required the PBGC to provide optional insurance to an employer who desires to protect against this contingent liability. Finally, Title IV grants the PBGC discretion to arrange reasonable terms for the payment of liability. 29 U.S.C. §1367. Thus Title IV of ERISA, unlike the statutes invalidated under Due Process or the Contract Clause does have "limitations as to time, amount, circumstances [and] need." W.B. Worthen, 292 U.S. at 434, 54 S.Ct. at 819. Id. at 962, 963. [Emphasis added]

MPPAA, however, is conspicuously lacking in such provisions. Instead, MPPAA treats withdrawing employers with the sort of "studied indifference" condemned in Worthen v. Kavanaugh, 295 U.S. 56, 60 (1935).

In affirming the Seventh Circuit decision in Nachman, the Supreme Court stated:

> Title IV became effective as soon as ERISA was enacted on September 2, 1974, §4082(a), 29 U.S.C. §1381(a) and indeed was expressly made partially retroactive in order to provide insurance coverage to participants whose plans terminated after June 30, 1974, §4082(b), 29 U.S.C. §1381(b). The measure of coverage, at the outset, was the difference between the employee's vested benefits under the terms of the plan (subject to the dollar limitations in §4022(b)(3), see n. 23, supra) and the amount that could be paid from

the terminated plan's assets. However, the employer liability provision, §4062, was not made effective at all during this initial period--June 30 to September 2, 1974. The PBGC was thus given no right to recover any part of the insured deficiencies from employers that terminated their plans before the Act became effective.

The second period lasted for 270 days after the enactment of ERISA, or until the end of May 1975. Again, the PBGC provided insurance coverage for most underfunded nonforfeitable benefits under the terms of a pension plan terminated during this period. But two important additional provisions became effective: §4062(b), the section creating employer liability to the PBGC, and §4004(f)(4), 88 Stat. 1009, 29 U.S.C. §1304(f)(4). The latter authorized the PBGC to waive entirely, or to reduce, its right to recover insurance payments from any employer who could establish unreasonable hardship in situations in which the employer was not able, as a practical matter, to continue its plan in effect. Section 4004(f)(4) unequivocally demonstrates that Congress had deliberately imposed a new liability upon an employer that terminated its plan during the first nine months of the operation of the Act. If the employer had a pre-existing contractual liability, there would have been no effective way for the PBGC to mitigate it in hardship cases, since the PBGC could not stop the employees from suing the employer directly. Moreover, there would have been no need for insurance except in cases of insolvency, and in such cases there would have been no practical reason for mitigation because recovery from the employer would have been impossible in any event. On the other hand, in the typical case in which the employer had protected itself from any contractual liability, the only possible source of employer liability was §4062's provision for the recovery by the PBGC of insurance payments made on account of unsatisfied nonforfeitable benefits. Petitioner's definition of nonforfeitable benefits as excluding from Title IV coverage all benefits for which the employer is not directly liable would have made §4004(f)(4) totally inapplicable in the only cases in which it could have possibly made any difference.

The third period lasted for about seven months until December 31, 1975, the termination date of petitioner's plan. Having terminated more than 270 days after the Act became effective, petitioner was not eligible for a hardship waiver. Its contingent liability, however, was smaller than it would have been had it terminated its plan in the fourth period. During the third period, the terms of the pension plan

> still measured the outer limits of the unfunded liability. Had petitioner waited another day to terminate, Title I's vesting standards would have become effective, thereby increasing the number of employees whose benefits would have become vested, see n. 6, supra, and therefore insurable under Title IV. Petitioner avoided this additional liability by terminating in the third period. Nachman v. PBGC, 446 U.S. 359 (1980), at 382, 383, 387. [Emphasis added]

The phase-in period was also the cornerstone in the Court's decision in Allied, wherein it stated:

> Compare the gradual applicability of ERISA, which itself is not even mandatory. At the outset ERISA did not go into effect at all until four months after it was enacted. 29 U.S.C. §1144 (1976 ed.). Funding and vesting requirements were delayed for an additional year. §§1086(b), 1061(b)(2) (1976 ed.). By contrast, the Minnesota Act became fully effective the day after its passage. The District Court rejected out of hand the argument that employers were constitutionally entitled to some grace period to adjust their pension planning. 449 F.Supp. at 651. Id. 249 n. 23, quoting. [Emphasis added]

Unlike ERISA, no phase-in period was provided under MPPAA before liability for complete withdrawals became mandatory. Unlike ERISA, no provisions were made for hardship exemptions. Unlike ERISA, there is no limit to the withdrawal liability imposed by MPPAA. Unlike the phased-in provisions of the Tax Equity and Fiscal Responsibility Act of 1982 which this Committee has just passed and has now become law, MPPAA had no phase-in provisions to ameliorate its draconian economic impact on Terson.

I respectfully commend the Committee for taking prompt action to change the effective date of MPPAA consistent with the decisions of the District Court in California, holding the retroactive period unconstitutional. I further respectfully

submit that Terson's reliance on its obligations under its collective bargaining agreements and its reliance on ERISA as construed by the United States Supreme Court should be the governing principles of this Committee in taking steps to cure the constitutional problems associated with the effective date of MPPAA. Consonant with those principles, I submit that the effective date of MPPAA should be, at least, January 1, 1981, to provide for a phase-in period to temper the unreasonable and unfair economic burden foisted upon Terson and other employers who had pre-September, 1980 commitments which were realized during the period between September 26th and December 31st, 1980.

Thank you for this opportunity to address the Committee.

Senator CHAFEE. You cite this *Natchman* case several times. I think that would have helped Mr. Riss in his situation. But I guess the court is still out on that. In other words, the way you cite the *Natchman* case—I should think it would apply to your situation; apply to Mr. Riss'. But Mr. Riss—his company is still tangled up in court on this.

Mr. MASTERSON. We are also, Senator, still tangled up in court.

Senator CHAFEE. All right. Senator Dole, do you have any questions?

Senator DOLE. No.

Senator CHAFEE. OK. Mr. Wilkinson.

STATEMENT OF ROBERT L. WILKINSON, PRESIDENT, ASSOCIATED SPECIALTY CONTRACTORS, INC., BETHESDA, MD.

Mr. WILKINSON. Mr. Chairman, I'm going to abbreviate my remarks in the interest of time. You will have the full statement, of course, filed with the committee for inclusion in the hearing record.

I'm Robert L. Wilkinson. I'm appearing here today as president of the Associated Specialty Contractors, Inc., which is an umbrella organization of eight large national specialty contractors associations, all of which are employers. Altogether in the segments of the industry that we represent, we have 165,000 business establishments, and about 1,300,000 employees. We have employers who are participants as both contributors and as trustees in thousands of multiemployer pension plans.

I am accompanied here by Peter Turza of Gibson, Dunn & Crutcher, who is our legal counsel on pension matters.

We are appearing today to express our support for the thrust of Senate bill 2860. This bill would eliminate the retroactive application of the withdrawal liability provisions of ERISA, as amended by the Multiemployer Pension Plan Amendments Act of 1980.

We would also like to express our appreciation to you, Mr. Chairman, and to Senator Dole for listening to our testimony.

We do not have the chronicle of very serious problems to report as described in the preceding testimony, although we have had a few problems among some employers. But we are greatly concerned about the retroactive provisions—of MPPAA as well as a number of other provisions of MPPAA that are causing really horrendous problems to employers who are participating in multiemployer pension plans.

I will just briefly comment, although I am sure you gentlemen already realize this, that until ERISA was adopted, the participants in multiemployer pension plans thought that their sole obligation was to pay a certain number of cents per hour worked toward the pension plans. With ERISA's passage, Congress added the obligation of requiring that employers pay for unfunded guaranteed benefits if the pension plan terminated. However, it was not until 1978 with the Federal circuit court's decision in *Connolly* v. *PBGC* that the court ruled that a multiemployer plan was a defined benefit plan covered by termination insurance.

The imposition of liability under the ERISA plan termination insurance program was limited in a few respects. However, these

limitations were eliminated by the 1980 amendment. Congress realized even in 1974 that the termination insurance scheme did not work for multiemployer plans and delayed the effective date of mandatory insurance coverage, subsequently extending a delay period until a new program could be worked out. We feel that this threat of very serious consequences to all pension plans, the pressure that was involved on all of us at that time—not only on Congress but those of us representing employers—resulted in the flawed political compromise which we now call MPPAA.

Essentially, this was an attempt to deal with difficulties that had been created in 1974. However, unfortunately, they did not solve the problem. The withdrawal liabilities imposed by MPPAA were much more severe on most employers than the ERISA termination liability provisions.

It is true that the severity of the impact of changes was reduced for construction employers. And, therefore, because of the special construction industry withdrawal rules, we in the construction industry supported MPPAA as the lesser of two evils.

However, we are of the view that MPPAA's scheme for imposing withdrawal liability on employers violates the U.S. Constitution. We agree entirely with Mr. Riss' analysis. And, in fact, the ASC has filed an amicus curiae brief in a case somewhat similar to Mr. Riss' case supporting the view that MPPAA is unconstitutional.

We believe that a partial breakthrough on this was accomplished by one judge who in two cases has thrown question on—in fact, has ruled that—the retroactive provision is unconstitutional. We hope, of course, in other cases like *Johnson Motor Lines,* they follow that decision on retroactivity.

The bill now before the Senate—Senate bill 2860—would provide relief to employers like those who are testifying today, and quite a few others, by eliminating withdrawal liability for employers who withdrew prior to the MPPAA enactment date. We support the basic concept of this bill.

We have, in fact, proposed similar relief for such employers in a comprehensive package of legislative amendments, which were presented to the chairman of the Senate Labor Subcommittee on July 28, 1982, copies of which were subsequently sent to all Senators. And this was a subject that you and I have discussed in the past, Mr. Chairman.

Major justification for a retroactive imposition of withdrawal liability, namely, to discourage employers from withdrawing from plans prior to MPPAA's passage, became weaker and weaker as enactment became more imminent. If Congress were faithful to the stated reasons for retroactivity, it would have eliminated the provision in the final stages of the legislative process. This, however, Congress failed to do. The ASC believes that Congress should correct its oversight.

The ASC's proposal to eliminate retroactive withdrawal liability is one of 15 amendments that is proposed to make MPPAA more bearable for employers. Other proposals include limiting the growth of unfunded vested benefits of multiemployer plans by permitting only financially secure plans to grant past service benefit increases and past service credits; imposing a risk related premium

on plans so that plans which pose a greater risk to the Pension Benefit Guaranty Corp. insurance system will pay a reasonably increased premium; increasing protections for employers against contribution increases while a plan is in reorganization; facilitating the sale of assets by reducing the incidence of withdrawals; and requiring the PBGC to prescribe actuarial assumptions to be used in calculating a plan's unfunded vested benefits for withdrawal liability purposes.

Senator CHAFEE. Mr. Wilkinson, your time is up. And I would say this. This is a very simple bill, which eliminates the retroactivity feature and moves it up to a certain date. Now if we proceeded with these suggestions you have here, this bill surely wouldn't pass in this session.

Mr. WILKINSON. I understand that.

Senator CHAFEE. So by coming forward with these suggestions, you would really be sinking 2860 unquestionably because these involve a whole new area of complexity that we just aren't prepared to get into. Today is Monday and the leader says we are going to be out of here Friday, and nothing is transpiring in either branch today, that is, on the floor. That gives us Tuesday, Wednesday, Thursday, and Friday, which is 4 days. So this is just no occasion for getting into anything beyond the changing of the date.

Now I think the points you make have some validity to them for future reference, if we can ever get into this morass again. It's not an area that I think any of us are anxious to deal with. The whole ERISA field is so complicated.

I don't know whether you want to proceed reading these or do you want to stick with just urging passage of 2860?

Mr. WILKINSON. Mr. Chairman, I think you have made the point that brings us here really. We recognize the urgency of this particular piece of legislation. We are extremely sympathetic to the employers that are involved in it. We would not want the complexity of ERISA to prevent Congress from acting further in the future. We don't expect anything, obviously, this year on the other portions of this reform. But we don't want the committee to feel that this reform would take care of the problems of ERISA to employers in general.

Senator CHAFEE. Well, I recognize that. I agree with that. I think for every person we straighten out today if 2860 should pass, there must be others who have equally urgent problems. And we will bear your recommendations in mind.

Mr. Turza, do you have a statement?

Mr. TURZA. Senator, I would just like to add that there is a coalition of about 24 trade associations that is working to come to agreement on supporting comprehensive amendments to ERISA. We hope to get results in about the next week or two and present these to the committee at a later date.

Senator CHAFEE. I think by later date you are meaning next calendar year?

Mr. TURZA. Yes. I think realistically we do not expect enactment in this Congress. But there are many employers who do very dramatically need relief from the provisions of the multiemployer amendments. A great deal of effort has been expended in trying to get many, many employers together to agree on this relief. And I

think we will be looking to the next Congress to try to move that legislation.

Senator CHAFEE. Well, since I am up for reelection and I can't make any promises, it's a very nice thing to have the chairman who will clearly be not only the chairman but will be here.

Senator DOLE. I will be glad to look into it. He will be here, too.

Senator CHAFEE. I guess the best we can say, Senator Dole, is that we will be listening and trying to look into it because we are conscious although this isn't our favorite area to delve into. [Laughter.]

OK. Fine. Anything else you gentlemen want to raise?

[No response.]

Senator CHAFEE. Well, again let me say that we will convey all of this to Senator Danforth and he will be extremely interested.

[The prepared statement of Robert L. Wilkinson follows:]

Statement of Robert L. Wilkinson on Behalf of
The Associated Specialty Contractors, Inc.
Before the Subcommittee on Savings, Pensions and
Investment Policy of the Committee on Finance of the
U.S. Senate on S. 2860

September 27, 1982

Mr. Chairman, my name is Robert L. Wilkinson, and I am appearing today as President of the Associated Specialty Contractors, Inc. ("ASC"). ASC is an "umbrella" organization of eight national associations*/ of construction specialty employer contractors. The segments of the construction industry represented by ASC affiliates consist of about 165,000 business establishments with annual sales of about $63 billion and 1,300,000 employees.

Appearing with me today is Peter H. Turza of the law firm of Gibson, Dunn & Crutcher. Mr. Turza serves as counsel to ASC on pension matters.

We are appearing today to express our support for the thrust of S. 2860. This bill would eliminate the retroactive application of the withdrawal liability provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") as amended by the Multiemployer Pension Plan Amendments Act of

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*/ Mason Contractors Association of America, Mechanical Contractors Association of America, Inc., National Association of Plumbing, Heating and Cooling Contractors, National Electrical Contractors Association, National Insulation Contractors Association, National Roofing Contractors Association, Painting and Decorating Contractors of America, and Sheet Metal and Air Conditioning Contractors National Association, Inc.

1980 ("MPPAA"). We would also like to express our appreciation to you, Mr. Chairman, and to the Committee for permitting us to testify today.

I. FROM ERISA TO MPPAA

Prior to the enactment of ERISA, the sole obligation of unionized employers regarding benefits under Taft-Hartley pension trusts was to make contributions on a cents-per-hour-worked or cents-per-unit-of-production basis pursuant to their collective bargaining agreements. The joint boards of trustees which ran the trust funds decided what benefits could be supported by employer contributions.

With ERISA's passage, Congress added to the obligations of employers contributing to multiemployer plans by requiring them to pay for unfunded guaranteed benefits if the pension plans terminated. It was not until 1978, however, that a federal circuit court ruled that a multiemployer plan was a defined benefit plan covered by termination insurance. See, Connolly v. PBGC, 581 F.2d 729 (9th Cir. 1978), cert. denied, 440 U.S. 935 (1979). The imposition of liability under the ERISA plan termination insurance program was ameliorated by the following factors: a thirty percent of net worth limit on liability for each plan (if an employer were associated with more than one terminated plan, its total liability could exceed thirty percent of net worth); a promised Contingent Employer Liability Insurance ("CELI") program to

insure employers against liability; a delayed effective date for mandatory guarantees by the Pension Benefit Guaranty Corporation ("PBGC"); and plan termination, a relatively rare occurrence, being the event triggering liability.

Realizing even in 1974 that the termination insurance scheme did not work for multiemployer plans, Congress delayed the effective date of mandatory insurance coverage and subsequently extended this delay period until a new program for multiemployer plans could be developed. The general consensus was that if the ERISA insurance program became mandatory, it would be economically advantageous for certain plans with large unfunded liabilities to voluntarily terminate and dump their liabilities on the insurance system. The 30 percent of net worth limit on liability would have shielded contributing employers from the greater liability of funding these plans' benefits. If these plans as well as certain others experiencing financial difficulties terminated, the insurance premium required from continuing plans was estimated to be as high as $80 per participant per year. Such a premium would have destabilized healthy multiemployer plans and accelerated their decline.

In addition, ERISA's imposition of liability on employers who had contributed to a plan during the five years preceding the plan's termination encouraged employers to withdraw from a plan at the first sign of plan decline in order to avoid being part of a "last man's club."

With the threat of mandatory insurance coverage going into effect and the continued Congressional commitment to some type of plan termination insurance program, a flawed political compromise called MPPAA was enacted into law. Essentially, MPPAA was an attempt by Congress to deal with the difficulties it had created for itself in 1974 by establishing the plan termination program.

The withdrawal liability imposed by MPPAA on employers in most affected industries was more severe than the ERISA termination liability in that: the thirty percent net worth limit was repealed; the CELI promise was eliminated; the event triggering the imposition of liability was changed from plan termination to the more frequent withdrawal of an employer from a plan; and a mandatory guarantee program was finally established. The severity of the impact of these changes, however, was reduced for construction employers by the special MPPAA construction industry withdrawal rules which made possible construction employer support for MPPAA.

II. UNCONSTITUTIONALITY OF MPPAA

ASC is of the view that MPPAA's scheme for imposing withdrawal liability on employers, whether construction or not, violates the United States Constitution.

Recently, ASC filed an amicus curiae brief supporting the plaintiff employer in Keith Fulton & Sons, Inc. v. New England Teamsters and Trucking Industry Pension Fund,

No. 81-2738 (D. Mass., filed Oct. 27, 1981). We argued in our brief that MPPAA's requirement that a withdrawing employer assume an enormous liability beyond that attributable in any way to his conduct vis-a-vis his employees or the plan violates the Due Process Clause of the Fifth Amendment. We also argued that Congress' delegation to private groups (i.e., plan trustees) the public authority to define and adjudge property rights of others without potential de novo review of a court of law also violates due process.

We also agree with many of the theories advanced by others that MPPAA is unconstitutional. We particularly agree that MPPAA's retroactive imposition of liability upon employers who withdrew prior to September 26, 1980 (MPPAA's enactment date) and after April 28, 1980 is unconstitutional. This position was accepted by Judge Hill in Shelter Framing Corp. v. Carpenters Pension Trust for Southern California, 3 EBC 1683 (BNA) (C.D. Cal., July 9, 1982) and G & R Roofing Company v. Carpenters Pension Trust for Southern California, 3 EBC 1683 (BNA) (C.D. Cal., July 9, 1982). We think Judge Hill's opinion, to the extent it deals with the retroactivity issue, is correct, and we hope courts in other cases like Johnson Motor Lines v. Central States, Southeast and Southwest Areas Pension Fund, No. 81 C 3703 (N.D. Ill., filed July 1, 1981) will follow his decision on retroactivity.

III. LEGISLATIVE SOLUTIONS

S. 2860 would provide relief to employers like those in Johnson Motor Lines and Shelter Framing Corp. by eliminating withdrawal liability for employers who withdraw prior to MPPAA's enactment date. Reserving the right to further review certain technical aspects of the bill, ASC supports the basic concept of S. 2860 to eliminate the imposition of liability for withdrawals prior to September 26, 1980. In fact, ASC proposed similar relief for such employers in a comprehensive package of legislative amendments (Sections 112 and 113 of ASC's proposed bill) which were presented to the Chairman of the Senate Labor Subcommittee on July 28, 1982. Copies of the ASC proposals were subsequently sent to all Senators.

The major justification for a retroactive imposition of withdrawal liability, namely to discourage employers from withdrawing from plans prior to MPPAA's passage, became weaker and weaker as enactment became more imminent. If Congress were faithful to the stated reason for retroactivity, it would have eliminated the provision in the final stages of the legislative process. This, however, Congress failed to do. ASC believes that the Congress should correct its oversight.

ASC's proposal to eliminate retroactive withdrawal liability is one of fifteen amendments it has proposed to make MPPAA more bearable for employers. Other proposals include:

- Limiting the growth of unfunded vested benefits of multiemployer plans by permitting only financially secure plans to grant past service benefit increases and past service credits;

- Imposing a risk-related premium on plans so that plans which pose a greater risk to the Pension Benefit Guaranty Corporation ("PBGC") insurance system will pay a reasonably increased premium;

- Increasing protections for employers against contribution increases while a plan is in reorganization;

- Facilitating the sale of assets by reducing the incidence of withdrawals; and

- Requiring the PBGC to prescribe actuarial assumptions to be used in calculating a plan's unfunded vested benefits for withdrawal liability purposes.

Since ASC's presentation of its legislative package in July, we have joined forces with at least fifteen other employer trade associations in developing a proposed bill which will provide relief from various aspects of MPPAA for most covered employers. Members of the coalition represent employers in such diverse industries as construction, food processing and distribution, graphic arts, and apparel manufacturing. We are very near finalizing the coalition's legislative amendments which we believe will form the foundation for comprehensive relief from the excesses of MPPAA.

We wish to bring to the attention of this Committee, Mr. Chairman, that there are a large number of employers throughout the country who have been adversely affected by MPPAA in one way or another. ASC believes, as do the other members of the broad-based and growing coalition of employers

of which we are a part, that the Congress should provide comprehensive relief for all affected employers. We hope to be able to work with you, Mr. Chairman, and the other members of the Committee in solving the retroactive liability problem and, in general, to make life liveable again for employers covered by multiemployer plans.

Thank you, Mr. Chairman, for your attention. We would be happy to answer any questions.

Senator DOLE. There is a chance, Mr. Chairman, that we will be having our last markup meeting, before we come back in November, tomorrow afternoon at 2 or 2:30. It may be possible to add S. 2860 to one of those bills.

Senator CHAFEE. Well, on that high note——

Mr. TURZA. May I just add that we may have certain technical comments on the language of S. 2860. We, of course, don't want to go into them now.

Senator DOLE. Don't tarry too long.

Senator CHAFEE. No. This is a case where time is of the essence. [Laughter.]

OK. Fine. Thank you.

Mr. RISS. Senator, I don't have to say how much we would appreciate that.

Mr. MASTERSON. Senator, if I could ask just one last question, S. 2860, as it currently stands, only moves the enactment date up to September 26, I believe. Is there any reason for any optimism that it could be moved up to January 1, 1981?

Senator CHAFEE. I couldn't say that flatly here without knowing the pros and cons; whether we would be opening a whole hornet's nest of problems for us by going forward to another date. I just don't know.

Senator DOLE. We are going to be looking at that between now and tomorrow afternoon.

Mr. MASTERSON. Thank you.

Senator DOLE. You might want to visit with staff, too.

Senator CHAFEE. Yes; if you can convince them because this is a technical field. I think it would be worthwhile spending some time with them.

OK. Fine. Thank you very much, gentlemen.

Why don't we take Mr. Kent Christison on S. 2232, a bill that Senator Helms is interested in.

Now Senator Helms was unable to be here this afternoon, but he has a statement in support of this measure which applies to a Mr. John Pope in North Carolina. So we will submit Senator Helm's statement for the record.

[The prepared statement of Senator Helms follows:]

PREPARED STATEMENT OF SENATOR JESSE HELMS

Mr. HELMS. Mr. Chairman, members of the committee, thank you for the opportunity to appear before you today to testify on behalf of S. 2232. It is an honor and a privilege to be here.

S. 2232 is a bill for the private relief of Mr. John W. Pope, a taxpayer in North Carolina. At the outset, let me say that I did not offer this bill without giving it serious thought. A private relief bill is a bit unusual in most cases and very unusual for me. But I have studied carefully the predicament John Pope found himself in, and I have concluded this is the fairest and most equitable way to help him.

Mr. Pope had a pension plan with his company, Variety Wholesalers, Inc. The plan was terminated in 1976, and there was a distribution of all the plan's assets in December of that year except for an insurance policy on Mr. Pope's life. Mr. Pope wished to purchase the life insurance policy but could not because the Department of Labor and the IRS considered the transaction to be prohibited under ERISA.

In early 1977 Mr. Pope established a rollover IRA account with the proceeds from his payout. Also in early 1977, the DOL/IRS changed its regulations governing the sale of a life insurance policy by a pension plan to allow such a sale. Mr. Pope was able to purchase his policy, and he promptly deposited these funds in a rollover IRA account. A complete rollover of all funds received by Mr. Pope from the terminated pension plan was thus accomplished within 60 days of the plan's termination.

The IRS audited Mr. Pope's 1976 and 1977 tax returns and disallowed the entire rollover because of a technicality that requires all payouts to be made within 1 calendar year. The IRS assessed an income tax deficiency, plus interest and a substantial penalty.

Mr. Chairman, Mr. Pope has been unjustly penalized by the IRS because DOL/IRS changed the rules regarding the sale of a life insurance policy by a pension plan. When Mr. Pope's pension plan was terminated, DOL/IRS regulations barred the sale of his life insurance policy. But within weeks the DOL/IRS changed its regulations to allow such a sale.

Congress never intended to penalize taxpayers who comply with requirements of the Employee Retirement Income Security Act, but who nevertheless face adverse treatment by the IRS because the payout of the proceeds of a terminated pension plan straddles 2 calendar years.

Mr. Chairman, my bill simply provides that in the administration of the provisions of section 402(a)(5) of the Internal Revenue Code of 1954, that portion of the distributions received by Mr. Pope from the Variety Wholesalers, Inc., pension plan during December 1976 and January 1977, and deposited into an individual retirement account described in section 408(a) of the Code, shall be treated as a qualifying rollover distribution and shall not be included in gross income. The bill would also allow Mr. Pope to file a claim for credit or refund which is attributable solely to the enactment of my bill within 1 year after the date of its enactment.

Mr. Chairman, thank you again for the opportunity to testify before you today. I urge you and other members of the committee to support S. 2232. Thank you.

Senator CHAFEE. All right. Mr. Christison. Have I got the correct pronunciation?

Mr. CHRISTISON. That's correct. Christison.

Senator CHAFEE. Why don't you proceed?

STATEMENT OF KENT CHRISTISON, ATTORNEY, POYNER, GERRAGHTY, HARTSFIELD & TOWNSEND, RALEIGH, N.C.

Mr. CHRISTISON. To identify myself again, I am Kent F. Christison. I'm an attorney in Raleigh, N.C. And today I am accompanied by a partner of mine, Lacy H. Reaves, to my right who is also a practicing attorney in Raleigh. And to my left is a representative of North Carolina National Bank out of Charlotte, Mr. Tom Payne.

We appreciate the opportunity to appear before you today. And as noted in the detailed memorandum, which I have submitted in support of this legislation, we are appearing to give testimony with respect to Senate bill 2232. That bill was introduced by Mr. Helms in March 1982 to give equitable tax relief to John and Joyce Pope.

If I may for a moment, to refer to your comments, the pension area is quite complicated. And this is an example where a complication and a technicality in the pension area has resulted in an extreme tax consequence to an unwary taxpayer.

The technicalities of compliance with IRA rollovers are complicated enough. In this case, the effectiveness of the tax law was further defeated, I believe, because we had some governmental agencies who were involved in the control of assets that were in the pension plan at this time. And because of their uncertain regulatory policy with respect to those assets, the taxpayer and the trustee, North Carolina National Bank, were led into a situation of noncompliance with the technical rules.

For that reason, I think, in this unusual circumstance that the taxpayer merits relief via private legislation. If I may, I would like to summarize the facts and circumstances. And, hopefully, in a very summary fashion which will justify that relief.

Mr. Pope was a participant in the pension plan of Variety Wholesalers, Inc., which was terminated effectively and duly in February 1976. The assets in his account with that pension plan was comprised of cash and an insurance policy on his life with a specified cash reserve value. Pursuant to the Pension Benefit Guaranty Corporation authorization, the assets were scheduled to be distributed in December 1976, and the trustee, in fact, started distribution in the middle of December 1976.

Mr. Pope wished to maintain his insurance policy, and also defer the immediate tax consequences on the distributions by effecting a tax free rollover as is allowed under the code under section 408. Unfortunately, at the time the IRA's—individual retirement accounts—were not permitted to own insurance policies. Mr. Pope, therefore, revised his election and entered into a transaction or proposed transaction with the trustee whereby he would buy his insurance policy for its cash reserve value, thereafter receive the policy and the resultant cash proceeds in the plan, and subsequently roll those over within 60 days to an IRA.

Again, unfortunately, there was a regulatory obstacle. At that time, the Department of Labor and the Internal Revenue Service considered, pursuant to a regulation, that the sale of insurance policies by a plan to an insured participant was a prohibited transaction, which was subject to penalties and which was subject to tax.

Therefore, he was unable to accomplish, at least during 1976, the actual IRA rollover. The regulation which I cite, which was, as I said, promulgated by the Department of Labor and the Internal Revenue Service, was a subject of criticism, a subject of uncertainty, and, in fact, a subject of quite a bit of noncompliance during 1975 and 1976.

The Federal Register would reflect that there were numerous applications for individual exemptions from the particular prohibited status of the transaction. Accordingly, the Internal Revenue Service and the Department of Labor were rather liberal in their enforcement policy with respect to the exempt status of the proposed policy sale. And, in addition, there was anticipation that the regulation would change.

The regulation did not change during 1976. The trustee, NCNB, was uncertain as to the regulatory status, noting that other institu-

tional investors engaged in noncomplying acts with the hope that it would subsequently be exempt through a class exemption from prohibited status. NCNB advised the taxpayer in 1976 that they would have to maintain the policy. However, it proceeded to distribute a portion of cash proceeds of the pension account in December 1976.

Subsequently, in January 1977, prior to official notice of a class exemption for the prohibited transaction, the trustee distributed the insurance policy and the proceeds. That is, the insurance proceeds were purchased by Mr. Pope, and he then rolled over the insurance proceeds and the cash proceeds which he had received in December to an IRA within 60 days.

The problem, if I may have just a few more seconds——

Senator CHAFEE. You go ahead. Mr. Pope certainly was embarking on a difficult future here, wasn't he?

Mr. CHRISTISON. I hope that it's adequately explained in the detailed memorandum which I have submitted.

The problems that Mr. Pope faced was that because of the complications of the code requirements, he was forced to rely on a trustee in hopes that a tax free rollover would be effected. In addition, we had a very unsure and cloudy regulatory situation.

As you probably know, the Internal Revenue Code requires that in order to be eligible for a lump sum distribution and subsequently a tax free rollover, all proceeds, all terminating proceeds, from a plan must be accomplished in 1 year. This creates a very difficult situation where a plan is terminated toward the end of the year because the definition of a lump sum distribution requires all proceeds to be received in 1 calendar year of the taxpayer.

Now the complications, and what I think merits the relief to Mr. Pope in this particular instance, are that we had other difficulties that were at work which resulted in a defective rollover. No. 1, we had a very unsure regulatory posture, the posture of the sale of insurance policies to an insured participant. That particular regulation was subsequently amended in June 1977, effective retroactive to January 1975. The unsure regulatory policy contributed toward the defective rollover that was accomplished by the trustee in this instance.

Second, the revenue agent who reviewed the returns for Mr. Pope was not aware of the regulatory circumstances that prevailed in 1976, nor was he aware that the regulation had been changed, so that retroactively the sale of insurance policies was allowed. And, finally, Mr. Pope was in a position where he must rely on a trustee, who, again, was trying to rely on an uncertain regulatory policy to effect a tax free rollover.

All these factors were beyond his control and yet he, who believed that he had effected a rollover and did roll over the proceeds within a 60-day period, was faced with a rather catastrophic tax result. That is, $73,000 plus of tax assessment, which has been duly paid.

I might note that in this private legislation, which is an attempt to seek justice and equity in tax administration, that no tax revenue is, in fact, lost to the Government because upon distribution of the terminating proceeds from the pension plan, from an IRA, after Mr. Pope reaches age 59½, the proceeds will be then taxed as ordinary income.

Senator CHAFEE. What are you specifically asking us to do?

Mr. CHRISTISON. The Senate bill 2232 proposes to qualify the split-year distribution which was received by Mr. Pope in December 1976, January 1977 as a qualified rollover distribution. And thereby cure the defective rollover which technically he is guilty of.

Senator DOLE. I have been advised there is no other case like this.

Senator CHAFEE. Did you say he has paid his tax?

Mr. CHRISTISON. He has been assessed and paid $73,000 plus tax.

Senator DOLE. He's got a problem.

Senator CHAFEE. He must be intensely interested in this legislation.

Mr. CHRISTISON. He's very intensely interested. And as you can see, the problem is even worse because you are assessed that tax and yet you do not have the proceeds that are now in an IRA—trapped in an IRA—to pay the tax. If he were to take those proceeds out of the IRA which he rolled over and which was not recognized as a tax free rollover, he would be penalized 10 percent of the amount in the IRA account. There are extreme penalties for premature withdrawal from an IRA. He is incurring a 6-percent penalty each year for excess contributions to an IRA account. These are all regulatory provisions.

Senator CHAFEE. Generally, what kind of luck does Mr. Pope have on things? It seems to me everything just broke wrong here.

Mr. CHRISTISON. He has hired a——

Senator CHAFEE. I won't pursue that. That's an unfair question. I hope he is luckier in other things than he was in this transaction, which seemed to be ill-starred.

As Senator Dole mentioned, I understand this is really a unique situation. And as you pointed out, the Treasury is going to get the revenue eventually but not at this time and in this fashion.

Well, thank you very much, gentlemen.

Do you have any questions, Senator Dole?

Senator DOLE. No. This might be another very small matter that we might be able to take care of tomorrow.

Mr. CHRISTISON. We appreciate your time.

Senator CHAFEE. Thank you. I take it that you have talked with the staff on this also. Is the staff aware of it?

Mr. CHRISTISON. Yes, sir.

Senator CHAFEE. Thank you very much.

[The prepared statement of Kent Christison follows:]

MEMORANDUM

TO: Subcommittee on Savings, Pensions, and Investments of the Committee on Finance United States Senate

FROM: Poyner, Geraghty, Hartsfield & Townsend, Attorneys for John W. and Joyce W. Pope (Kent F. Christison and Lacy H. Reaves)

RE: S2232 - Bill Introduced by Mr. Helms for Relief of John W. and Joyce W. Pope

This Memorandum is submitted by the undersigned on behalf of John W. and Joyce W. Pope for introduction on the record in respect to the hearing conducted by Subcommittee on Savings, Pensions, and Investments of the Committee on Finance, United States Senate to consider SENATE BILL 2232. This bill was introduced by Senator Helms on March 18, 1982 for the purpose of achieving equitable tax relief for John W. Pope and Joyce W. Pope (sometimes jointly referred to as "Taxpayer").

SUMMARY

Taxpayer was a participant in the Pension Plan of Variety Wholesalers, Inc. ("Plan") which was duly terminated on February 20, 1976. At termination, the balance of Taxpayer's account consisted of cash and an insurance policy with a specified cash reserve value. Pursuant to the authorization of the Pension Benefit Guaranty Corporation (PBGC), North Carolina National Bank, Trustee of the Plan ("Trustee"), began distribution of Plan assets in December, 1976. Taxpayer desired to maintain the insurance policy in his account and defer immediate tax on distributions by effecting a tax-free rollover of terminating plan distributions to an Individual Retirement Account (IRA) under Section 408, Internal Revenue Code ("IRC"). An IRA was not permitted to receive and own an insurance policy under applicable law. Taxpayer therefore elected to purchase his insurance policy from the Plan at its cash surrender value with purchase proceeds and policy thereafter being distributed to him from the Plan. However, the sale of individual life insurance contracts by a pension plan to a participant insured thereunder was considered by the Department of Labor (DOL) and the Internal

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Revenue Service (IRS) to be a prohibited transaction under Section 406(a) of ERISA subject to tax under Section 4975, IRC. The prohibited status of such policy sales were the subject of substantial public uncertainty, criticism, and noncompliance as well as numerous applications for individual exemptions. Such activity prompted minimal enforcement efforts and reevaluation of prohibited status by DOL and IRS and it was anticipated during 1976 that policy transfers such as the policy sale elected by Taxpayer would be subject to a regulatory class exemption.

Trustee notified Taxpayer in 1976 that the anticipated regulatory exemption had not been issued and that the policy must be maintained in the Plan pending formal exemption. Trustee proceeded to distribute the cash portion of the Taxpayer's account - $61,950.63 - to him on December 16, 1976. Trustee subsequently sold the policy and distributed the cash proceeds of $41,961.28 produced from such sale to Taxpayer on January 21, 1977 before adoption of a regulatory exemption. Taxpayer established an IRA account with Trustee and contributed the aggregate terminating distributions of $103,911.91 to such account in January, 1977 within sixty (60) days of receipt in the good faith belief that he had effected a tax-free rollover.

The proposed regulatory exemption of policy transfers to the insured participant was subsequently promulgated on June 15, 1977, and published on June 21, 977 in the Federal Register (42 FR 31574). The regulatory exemption was made retroactively effective to January 1, 1975.

Section 402(a)(5), IRC, provides that a "qualifying rollover distribution" received by a participant in a qualified plan is not includible in gross income for the taxable year received if transferred within 60 days of receipt to an IRA. A "qualifying rollover distribution" is defined by Section 402(a)(5)(D)(i) as one or more distributions which constitute a "lump sum distribution" within the meaning of Section 402(e)(4)(A). Section 402(e)(4)(A) defines a lump sum distribution as a distribution within one taxable year of the recipient.

The Internal Revenue Service determined that the tax-free rollover contribution of terminating distributions should be disallowed because they were received by Taxpayer in two (2) tax years (December, 1976 and January, 1977) and did not qualify as "qualifying rollover distributions" under Section

402, IRC, and that the IRA contribution of $103,911.91 constituted an excess contribution under Section 4973, IRC. The IRS determination resulted in assessment and payment of income tax deficiencies and interest of $67,619.65 as a result of disqualified rollover and excess contributions tax of $6,234.71 - a total of $73,854.36.

S2232 seeks to achieve fairness and equity in tax administration in this instance by providing that the portion of the distributions received by John W. and Joyce W. Pope from Variety Wholesalers, Inc. Pension Plan during December, 1976 and January, 1977 and deposited within sixty (60) days in an Individual Retirement Account shall be treated as a "qualifying rollover distribution" for the purposes of Section 402, IRC.

The facts, legal precedent, and equitable factors compelling legislative relief are outlined in a detailed statement hereunder. Careful consideration of these factors demonstrates that the disallowance of qualified IRA rollover was attributable to:

(1) Uncertain regulatory policy of the Department of Labor and the Internal Revenue Service with respect to the prohibited status of the sale of insurance policies to insured participants.

As noted, the prohibited status of such insurance policy sales was exempted from prohibited status retroactive to January 1, 1975.

(2) Erroneous interpretation of the facts and law pertinent to distribution and rollover by the revenue agent examining the tax returns of Taxpayer, particularly his lack of familiarity with the regulatory provisions applicable to insurance policy sales by a plan to a participant and the effect of such provisions on the availability of Plan account assets to the Taxpayer.

(3) The split-year distributions by the Trustee responsible for terminating the Plan and establishing a tax-free rollover.

Lack of control of such factors by Taxpayer who innocently believed that he had complied with Section 402 tax-free rollover requirements, the extensive equitable factors cited hereunder,

and the catastrophic tax consequences attending the disqualification justify tax relief through remedial legislation.

It is important to note that the Treasury defers rather than loses revenue under this Bill since the aggregate terminating distribution of $103,911.91 which becomes qualified for rollover will be taxed as ordinary income at disbursement from an Individual Retirement Account to Taxpayer.

DETAILED STATEMENT
RE
S.2232

The Pension Plan ("Plan") of Variety Wholesalers, Inc. was terminated February 20, 1976. Certification regarding termination was duly filed with the Pension Benefit Guaranty Corporation (PBGC) which issued Notice of Sufficiency regarding Plan assets on December 2, 1976. Such Notice permitted completion of Plan termination by distribution of Plan assets. Terminating distributions were accordingly undertaken by the Trustee during the month of December, 1976.

The asset balance of Taxpayer's account under the Plan as of the termination date of February 20, 1976, consisted of cash in the amount of $61,950.63 and a life insurance policy with cash surrender value of $41,961.28. Taxpayer was granted the following options in respect to the insurance policy:

(1) Distribution of the insurance policy as of February 20, 1976;

(2) Termination of the insurance policy and distribution of its cash surrender value as at February 20, 1976;

(3) Purchase of the insurance policy from the Plan at its cash surrender value as at February 20, 1976 with purchase proceeds and policy thereafter being distributed in cash to Taxpayer; or

(4) Purchase of the insurance policy from the Plan at its cash surrender value as at February 20, 1976 with policy being distributed and resultant cash balance in Taxpayer account being maintained in trust for subsequent distribution at death, age 59-1/2, disability, or termination of employment.

Election of an option established the preference of Taxpayer concerning the account but was not irrevocable and therefore did not restrict Taxpayer from revising an election and thereby becoming eligible to receive his account in an alternative manner. It is important to note that Taxpayer did modify his initial election and such modification was recognized and honored by the Trustee.

Taxpayer desired to maintain the insurance policy and defer tax on the terminating distributions and therefore initially elected to purchase the policy and maintain the resultant cash balance in the Plan account in trust under option (4). Coincident with such election, Taxpayer assumed full responsibility for maintenance of the policy and immediately commenced to pay premiums. Taxpayer was subsequently informed by the Trustee that he could maintain the policy and defer immediate tax on distributions by effecting a rollover of terminating plan distributions to an Individual Retirement Account (IRA). Taxpayer was further informed that an IRA was not permitted to receive and own an insurance policy under applicable law. In response, Taxpayer modified his intentions and elected option (3) as a means of maintaining the policy and preserving eligibility of terminating plan distributions for tax-free IRA rollover in compliance with Section 402, IRC.

The revised election was made by Taxpayer with the assurances of Trustee that terminating distributions and rollover contributions to an IRA established by Trustee would be achieved by and at the direction of Trustee in compliance with the tax-free rollover requirements of Section 402, IRC.

Uncertain Regulatory Policy of DOL/IRS Contributes to Split Year Distributions; Regulatory Exemption Retroactively Cures Defect

At the time of the revised election, Trustee understood and advised Taxpayer that the sale of individual life insurance contracts by the Plan to the participant insured thereunder was considered by DOL and IRS to be a prohibited transaction under Section 406(a) of ERISA subject to tax under Section 4975, IRC. The prohibited status of a policy sale was the subject of substantial public uncertainty due to the historical practice by plans to permit an insured participant to purchase a policy in instances where it would otherwise be surrendered. Such uncertainty was understood by Trustee to result in numerous applications for individual exemptions, the

occurrence of policy sales without individual exemptions, and reevaluation of prohibited status by DOL and IRS. It was therefore anticipated during 1976 that the proposed policy conveyance would be the subject of a class exemption.

In the interim, anticipation of an express class exemption prompted frequent noncompliance by plan administrators without risk of DOL/IRS compliance action due to apparent policy of nonenforcement by DOL and IRS. The inconsistency between prohibited regulatory status and DOL/IRS enforcement posture significantly contributed to defective rollover of terminating distributions by Trustee on behalf of Taxpayer.

The Trustee was confused by the "hybrid" regulatory posture of the proposed policy sale at disbursement of terminating distributions in December, 1976. In view of such circumstances, Trustee would have transferred the policy to Taxpayer in accord with option (3) in December, 1976, if Taxpayer had so demanded. However, Trustee notified Taxpayer in December, 1976, that anticipated regulatory exemption had not been issued and that the policy must be maintained in the Plan pending formalization of the exemption. Despite such notification and the qualified rollover responsibility assumed by Trustee, Trustee distributed the cash portion of Taxpayer's account on December 16, 1976. Trustee notified Taxpayer of intent to proceed to sell policy by letter dated January 17 and subsequently sold the policy and thereafter distributed the remaining cash proceeds to Taxpayer on January 21, 1977, before adoption of a regulatory exemption.

Taxpayer established an IRA account with Trustee and contributed all terminating distributions to such account in January, 1977 within sixty days of receipt of terminating distributions in the good faith belief that he had effected a tax-free rollover. Taxpayer was not informed of any potential defects concerning the presumed tax-free rollover until audit and was therefore deprived of any opportunity to minimize or avoid tax assessments attributable to alleged defective rollover.

On January 21, 1977, notice was published in the Federal Register (42 FR 4036) that DOL and IRS were considering the exemption of policy conveyances described above from prohibited status. The proposed regulatory exemption was subsequently promulgated on June 15, 1977, and published on June 21, 1977, in the Federal Register (42 FR 31574). In recognition

of prior public uncertainty and resultant noncompliance, the regulatory exemption was made retroactively effective to January 1, 1975.

As noted below, the retroactive date of the exemption and the retroactive cure of any alleged regulatory restrictions on the availability and distribution of the entire plan account to Taxpayer in December, 1976, for purposes of constructive receipt under Section 402, IRC was either unknown or ignored by the Revenue Agent in considering the proper tax treatment of the terminating plan distributions.

Factual Circumstances and Retroactive Regulatory Exemption Ignored by Revenue Agent

Taxpayer timely filed tax returns for tax years ending December 31, 1976 and December 31, 1977. Such returns were examined and adjusted by a Revenue Agent pursuant to report (Form 4549-A) dated December 12, 1978. The Revenue Agent determined that the tax-free rollover contribution of terminating distributions aggregating $103,911.91 should be disallowed due to receipt by Taxpayer in two tax years in contravention of Section 402, IRC and that such aggregate contribution of $103,911.91 constituted an excess contribution under Section 4973, IRC. Such determinations resulted in assessment of income tax deficiencies and interest of $67,619.65 as a result of disqualified rollover and excess contributions tax of $6,234.71 - a total of $73,854.36.

As noted below, the severe tax consequences are compounded by the unavailability of the funds generating the assessments due to retention in the IRA and, more importantly, the adverse tax consequences associated with excess contributions to, and premature withdrawals from, an IRA.

The assessments by the Revenue Agent were based on an erroneous interpretation of facts and law pertinent to the terminating distributions and subsequent rollover. Specifically, the Revenue Agent ignored the applicability of the doctrine of constructive receipt citing the regulatory circumstances discussed above as imposing a substantial limitation or restriction on distribution. Accordingly, the Revenue Agent ignored regulatory circumstances during 1976 and the subsequent retroactive cure by regulatory exemption.

The Revenue Agent failed to consider the following operative factors which require a finding that the entire account of Taxpayer was constructively received in December, 1976:

(1) Factual Circumstances - All assets representing the account balance of Taxpayer as of February 20, 1976 were set apart and made available to him after receipt of the Notice of Sufficiency from PBGC without substantial limitations or restrictions and were considered to have been distributed and received by him in December 1976 under the concept of constructive receipt as defined and applied in Treas. Reg. §1.451-2; Treas. Reg. §20.2039-2(b); Rev. Rul. 54-265, 1954-2 CB 239; Northern Trust Company v. United States, 389 F.2d 731 (7th Cir., 1968); Blyler v. Commissioner, 67 TC 878 (1977); and Letter Ruling 7950014.

It is clear that the concept of constructive receipt is available to the Taxpayer as well as the government and that the authorities cited above favor a finding of constructive receipt in this instance. Accordingly, all terminating distributions were received by the Taxpayer in one tax year and were qualified for tax-free IRA rollover.

The continued status of policy sale as a prohibited transaction has been cited by the IRS as a substantial restriction on the availability of Taxpayer's account in December, 1976, under the option which he elected. This rationale ignors the following facts:

(a) The option elected by the Taxpayer served to express a preference concerning receipt of terminating distributions. Taxpayer could revise his election at any time and compel distribution of the entire account. Taxpayer did, in fact, modify his initial election. Retention of assets in Plan account after PBGC clearance was solely subject to volition of Taxpayer.

(b) In view of uncertain regulatory circumstances outlined above, Trustee would have performed the policy exchange and distributed all account proceeds to Taxpayer in December, 1976, if Taxpayer had demanded.

(c) Policy sale was de facto exempt under regulatory circumstances outlined above. Accordingly, distribution under option elected by Taxpayer was not subject to substantial regulatory restrictions; and

(d) Regulatory posture of policy sale did not constitute a substantial restriction on conveyance to Taxpaper in December, 1976, as conclusively evidenced by sale of policy in January, 1977, prior to regulatory exemption.

(2) Retroactive Regulatory Exemption - The regulatory exemption of the sale of a life insurance policy to an insured/participant was retroactively effective to January 1, 1975. Such effective date removed alleged restriction on availability of all Plan proceeds attributable to regulatory status and thereby eliminated primary rationale of IRS for determining that terminating distributions were not constructively received in December, 1976, within meaning of Treas. Reg. §1.451-2.

The retroactive date of the regulatory exemption and the accompanying retroactive cure of any alleged regulatory restrictions on Plan distributions were unfortunately either unknown or ignored by the Revenue Agent.

* * * * * * * *

The fairness and equity of the proposed legislation may be illustrated by the following factors:

(1) Taxpayer incurred severe tax consequences due to governmental and private sector factors beyond his control despite good faith belief of compliance with tax-free rollover requirements.

(2) Technical requirements of Section 402, IRC, necessitated reliance by Taxpayer on Trustee and precluded effective corrective action by Trustee or Taxpayer subsequent to split-year distributions.

(3) The tax adversity imposed on Taxpayer significantly exceeds the assessment of $73,854.36 due to tax rules applicable to premature IRA withdrawals and excess IRA contributions. Taxpayer was not informed of possible disallowance and had no opportunity to minimize adverse tax

consequences by timely elections or withdrawals. Accordingly, funds generating the assessments remained in the IRA and were not available for payment of the assessments.

Distribution from an IRA account prior to age 59-1/2 will not only result in the inclusion of receipts as ordinary income but will additionally require payment of a nondeductible penalty equal to 10% of the distributions. In addition, a Taxpayer who makes an excess contribution may suffer the following disastrous consequences: tax deductions disallowed to the extent of excess contribution, any amounts withdrawn will be included in ordinary income without offset for disallowed deduction and will be subject to the 10% premature withdrawal penalty, and the excess contribution amount will be subject to 6% excise penalty per year for each year retained in the IRA.

(4) The concept of receipt of Plan distributions in one tax year was initially employed to define lump sum distributions by the Revenue Act of 1942 as a means of relieving taxpayers of ordinary tax consequences associated with receipt of distributions and such concept has been carried forward in successor acts to apply to terminating distributions despite imposition of 60-day requirement. Contrary to initial tax relief intent, the one-year concept operates to impose a significant hardship on the Taxpayer in this instance.

(5) The rollover was effected within 60 days of terminating distributions as required by Section 402, IRC, despite receipt of such distributions in two tax years. The absence of tax abuse potential due to the 60-day requirement indicates that the requirement of receipt of terminating distributions in one tax year unnecessarily duplicates and complicates tax-free rollover requirements and results in a trap to the unwary taxpayer in instances of terminating distributions in December. It is difficult to avoid the trap and the tax consequences outlined in (3) because a taxpayer may not discover the problem until audit.

The absence of the need for the one taxable year receipt requirement is demonstrated by the lack of such requirement to a rollover of an account from one IRA to another IRA under Section 408, IRC.

(6) The arbitrary and inequitable impact of the one-year requirement is apparent from the comparative consideration of the tax-free rollover eligibility of: retention of multiple terminating distributions received from January through December of a calendar year, but rollover within sixty days of receipt of the last distribution; and receipt of all terminating distributions within one tax year, but four years after termination of a plan. See Rev. Rul. 60-292, Rev. Rul. 62-190, and IRS Letter Ruling 7802035 (10/13/77).

(7) Recent legislation (retroactively effective) and regulations have been adopted for the express purpose of reducing or avoiding rollover technicalities and resultant tax inequities imposed on participants who may have erred in determining the amount or composition of their plan account or the exact procedure for making a qualified rollover. See, Section 4(a) of Public Law 95-458 amending Code Section 402(a)(5)(A); Section 157(h)(1) of Public Law 95-600 amending Code Section 402(a)(5)(D)(i)(II); Section 2(b) of Public Law 95-608 amending Code Section 402(e)(6); and Treas. Reg. 1.402(e)-2(d)(1)(ii)(b).

(8) Individual pension funds which are ordinarily accorded favored tax status due to government policy of encouraging retirement planning may be significantly depleted due to technical compliance problems.

(9) The class exemption of insurance policy sales was made retroactively effective to January 1, 1975 in recognition of prior public uncertainty and resultant noncompliance. This protects prior transactions which technically violated the law. Failure to apply the exemption retroactively to cure the defective rollover operates to unfairly penalize persons who complied with the prohibitive status prior to exemption.

(10) Treasury will not incur significant loss of revenue because proceeds which are the subject of rollover to an IRA account will be taxed as ordinary income at disbursement to Taxpayer from the IRA.

Respectfully submitted,

POYNER, GERAGHTY, HARTSFIELD & TOWNSEND

By Kent F. Christison Kent F. Christison

By Lacy H. Reaves Lacy H. Reaves

KFC:pg

Senator CHAFEE. All right. Now let's take the next panel. Mr. Smith, past president of the Home Builders; Mr. Johnson and Mr. Scott McGregor.

Good afternoon. This is somewhat the lengthier part of the hearing today. It deals with the Residential Mortgage Investment Act of 1982, which I introduced. Many housing—and the purpose is to take a look at this and to get some testimony on it.

Many housing finance experts believe that current laws and regulations affecting pension funds are unduly restrictive when it comes to home mortgage investments. Pension funds must meet so many legal requirements before they can purchase mortgages that it puts even the most solid mortgage investment at a competitive disadvantage of other types of assets.

Now the goal of the legislation that we have before us is to open the way for all prudent investments, including mortgages, to be treated equally under the Nation's pension laws. It does not, by any means, require a pension fund to put their money into home mortgages. That is not something the Congress is in the business of doing. Pension funds are to be prudently invested. And it certainly isn't intended to permit pension funds to make investments at below market rates. The Residential Mortgage Investment Act is an important step in recognizing that the traditional sources of housing financing, those we are use to—those held at our local community savings and loan associations—will not be enough to satisfy the demands of future home buyers. The mortgage market is undergoing dramatic change; Congress should do everything in its power to assure that as these changes occur barriers be removed to free the flow of investor dollars into the housing market.

The significance of the legislation is that it will help remove these barriers and will permit the financial sector to increase the supply of capital for prudent, sound mortgage investments.

Now I believe this bill is important but I do not want to create the impression that it will be the instant answer to the problems of the U.S. housing industry. It will not do that.

During the hearing I conducted recently on pension fund investments in the mortgage market, it was indicated clearly that the main obstacle to fund investors is that mortgages have not yet been packaged as attractively as other kinds of security. It was the return that was deterring principally the pension funds from investing in mortgages. As a result, pension fund managers have not been as willing to invest in mortgages as they have in more traditional assets.

This bill will open the door to more rapid development of private sector secondary market for mortgage investments. Such a market will improve the liquidity and soundness of mortgage securities and make it easier for pension funds to acquire them.

Inevitably, all legislation affecting pension policy is complex and controversial. I want to seek the assistance of the pension industry, the housing industry, organized labor and the administration in shaping a legislative proposal we can all support—one that will bring the mechanisms of home mortgage finance up to date with other revolutionary changes we are now seeing in our financial institutions.

As far as I am concerned, the details of this proposal will be subject to the most careful scrutiny. While the housing industry has very serious problems, which we seek to remedy, my primary consideration in any legislation dealing with pension funds is that the benefits promised to workers and retirees be protected. That's my primary goal. It's to see that the moneys are there for the retirees.

In that regard, I do have some concerns about provisions in this bill that could open the way for pension funds to engage directly in making individual mortgage loans as would a savings and loan or mortgage company. The general thrust of the legislation is clear, however. It's intended to be as much a benefit to pension funds as it is to the housing sector.

So, gentlemen, why don't we start off? And I do want to pay tribute to the Home Builders who have worked so hard on this to say that I appreciate the help that they have given in working on this entire measure. And I hope we can come up with something constructive.

So, Mr. Smith, why don't you proceed?

STATEMENT OF HERMAN SMITH, PAST PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, WASHINGTON, D.C.

Mr. SMITH. Thank you, Mr. Chairman. I am Herman Smith of Fort Worth, Tex., the 1981 president of the National Association of Home Builders.

Senator DOLE. Excuse me. I appreciate very much you all being here. And I appreciate also Ed Beck's assistance in pushing us along here so we had this hearing. He is doing good work.

Mr. SMITH. Well, thank you. And it was good to work with you on the tax bill a month ago. Thank you.

Mr. Chairman, I might add also we appreciate——

Senator CHAFEE. Just one moment, Mr. Smith.

All right, Mr. Smith, why don't you proceed?

Mr. SMITH [continuing]. And, Mr. Chairman, we also appreciate your authorship of this bill, and your concern in moving it forward. Thank you very much.

The housing industry is in a severe depression due largely to the high rates of mortgage money and a shortage of available funds from potential mortgage investors. If something is not done soon to open new sources of mortgage investment capital and to bring down high interest rates, contractors will continue to go under in significant numbers.

I might add, Mr. Chairman, I am going to just summarize the written statement that we have brought forward for the record, if you will let us.

Another aspect of the housing depression involves the current movement to eliminate the distinction between savings and loan associations and banks. Savings and loan associations have historically been the single major source of long-term stable mortgage funds. The Depository Institution Amendments of 1982, the bill to restructure these financial institutions, was passed by the Senate on Friday. This restructuring would jeopardize the ability of thrift institutions to continue to be a source of stable, long-term mortgage financing.

I might add, Mr. Chairman, in conjunction with our testimony today we have submitted a chart that you should have a copy of that reflects what has happened in the past 10 years pertaining to the percent share of total mortgage funds advanced by savings institutions from 1970 to 1982. You will note that in 1971, approximately 55 percent of this share came from the thrifts. And if you will note, in the past year, this has been lowered to 3.6 percent. So you can see that well is drying up.

Now, pension funds invest about 3 percent of their assets in mortgages, including commercial mortgages. I might add that we think probably the portion going to residential mortgage financing factor has only been running between 1 and 1½ percent.

Since pension funds in the future could be the only stable source of long-term mortgage money, it is imperative that legal impediments to pension fund mortgage investments be removed. And furthermore that these actions be taken at the same time that Congress is restructuring thrift institutions.

NAHB supports Senate bill 2918, which will begin to solve these problems by removing artificial barriers that have inhibited the Nation's employee pension funds from investing in home mortgages. The ERISA standards were designed to encourage safe and sound investment returns and to protect pension fund participants from improper dealings. The congressional assumption behind adoption of these provisions was that dealings between pension funds and related parties are subject to abuse.

In recognition of these overly restrictive prohibited provisions, Congress established administrative procedures for relief from the restrictions. These administrative exemption procedures have proven to be largely unworkable. Obtaining a prohibited transaction exemption is extremely difficult, and once obtained, are generally burdensome and restrictive conditions are required.

This point is illustrated by the experience we had in seeking and obtaining a class exemption regarding residential mortgage transactions.

And I might add, Mr. Chairman, we have had a lot of experience within the last 2 years on this subject, and it has been very difficult.

The final whole loan exemption represents a substantial improvement over the exemption proposed last December, but several conditions are imposed in order for a pension plan to make a mortgage investment. While these are substantial improvements, the exemption does not provide the necessary flexibility.

The first problem is that the exemption treats mortgage investments as an inferior investment. And I believe this is something on which we have to focus. It is clear that mortgages have proven to be a superior form of investment.

I might add, Mr. Chairman—I noted in the paper of my home State of Texas last week an investment in the stock market cost our teachers' retirement fund $10 million.

Senator CHAFEE. Investment in what?

Mr. SMITH. Our teachers' retirement fund in the State of Texas recently purchased and sold thousands of dollars worth of stock in the Johns-Manville Corp. As of last week, the loss to the pension fund was $10 million.

So you can see that we think that mortgages certainly would not have been that susceptible to change. I know that we will need to move on and I will just conclude here by saying that conventional mortgage-backed securities are a relatively new instrument. You mentioned this in your opening statement, and we think this is a major concern.

A mortgage-backed security represents a partial interest in a pool of residential mortgages that has been insured either by private mortgage insurers or by the credit of the insuring institution. Most have a double A rating by Standards & Poor. Mortgages packaged in a security form are an instrument that pension fund investors can readily understand. While the development of and packaging some mortgages as mortgage-backed securities, we believe that pension funds will find them a very attractive instrument and that a private, secondary market will begin to develop very soon.

The safeguards of private mortgage insurance, which include the underlying security inherent in a mortgage and the creditworthiness of the issuer, are sufficient safeguards to make nonagency conventional mortgage-backed securities prudent.

We believe that given these problems, there is a clear and urgent need for Congress to enact legislation that will remove the second-class investment status that has been assigned to mortgages.

Senate bill 2918 does not mandate pension plans to invest in mortgages or even to consider residential mortgages as an investment alternative. The bill only removes existing regulatory and statutory barriers to such investments.

In conclusion, Mr. Chairman, NAHB strongly urges this subcommittee to take immediate action to report out Senate bill 2918 and bring it before the full Senate for consideration—especially in light of congressional passage of the financial institutions restructuring legislation.

Nothing short of immediate action—and we might add, Mr. Chairman, we hope this week—will allow residential mortgages to be considered on an equal basis with alternative mortgages.

Thank you, sir, for the opportunity to appear, and we will be pleased to answer any questions you might have.

Senator CHAFEE. Well, thank you, Mr. Smith. And I think I will just save my questions until the panel is through testifying.

[The prepared statement of Herman Smith follows:]

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

COMMITTEE ON FINANCE

UNITED STATES SENATE

on

S.2918, THE RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1982

SEPTEMBER 27, 1982

Mr. Chairman and Members of the Subcommittee:

My name is Herman Smith and I am a homebuilder from Ft. Worth Texas. I am testifying today on behalf of the more than 108,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry, of which I am Past President. I am pleased to be here to testify on S.2918, The Residential Mortgage Investment Act of 1982.

The housing industry today is in a severe depression due largely to the high rates of mortgage money. The shortage of mortgage investment capital at reasonable rates results in significant part from the disintermediation suffered by the thrift institutions because of bond, money market fund and certificate of deposit yields. Thrift institutions have been the principal supporters of the residential mortgage market for over 40 years. Today's interest rates have placed many middle-income families and first-time homebuyers out of the housing market causing the housing industry to suffer its worst economic downturn in 40 years. The facts and figures relating to the state of our industry are as follows:

HOUSING PRODUCTION

- New housing production in 1981 totalled 1.1 million units as against an annual need for new homes that has been estimated conservatively at 1.8 million units throughout the 1980s. Last year was the worst housing production year since 1946.

- 1982 could finish as the worst post-war production year yet. For the first 8 months of 1982, housing starts have run at levels 18% below the comparable period in 1981. This year should end with production even below last year's record-setting low level. In fact, any improvement in housing production this year has been the result of pushing government assisted units in the pipeline, particulary in the multi-family sector and even multifamily housing was down in August. Singlefamily starts will not improve substantially, if at all, this year.

- We are in the 43rd month of recession in housing. The previous record was set during the Eisenhower Administration when a housing recession lasted 27 months. This is longer than America's involvement in World War II.

NEW HOME SALES

- 1981 was the worst year for new home sales since the Census Bureau began collecting statistics in 1963. Only 436,000 new homes were sold, compared to 545,000 homes in 1980 and more than 800,000 in 1977 and 1978.

- Sales this year and in August 1982 continued to be very poor, as indicated by our builders Economic Council monthly survey, particulary the sale of single-family homes. Nearly 75 percent reported sales of single-family homes as poor.

INTEREST RATES

- Conventional mortgage interest rates still average 17%. Mortgage rates at such high levels price the vast majority of potential buyers out of the market.

- Interest rates normally fall rapidly and decisively during recessions, but in this downturn they have declined slowly and have remained in an historically high range. Analysts forecast that mortgage rates are not likely to drop below 15% this year, thereby killing off any chances for a housing recovery in 1982. The consensus is that home sales will remain at depressed levels until mortgage rates drop to the 14% range, which by historical standards still represents an extraordinary high cost of home financing.

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- By reducing interest rates from 16% to 12%, 4.6 million additional families could qualify for a $65,000 mortgage. At 12% interest rates, no more than 22% of the nation's families have the $35,000 income needed to qualify for a modest $65,000 mortgage. At 16% rates, fewer than 14% have the $44,000 income needed to qualify for the same mortgage amount.

UNEMPLOYMENT

- Unemployment in the construction trades in August was 20.3% with 1,035,000 unemployed workers, accounting for one out of every 10 unemployed members of the workforce. Another 200,000 skilled craftsmen could lose their jobs over the next several months.

- An estimated 200,000 self-employed people in construction-related businesses have either shut down or sharply curtailed their operations in the housing industry. Self-employed people are not counted in the Labor Department's unemployment statistics.

- Failure rates in construction for the first eight months of 1981 are up sharply compared to the same period in 1980. Bankruptcies are up 45% for construction firms and 61% for subcontractors.

- Rising joblessness toward levels not experienced since the 1930s continues to feed the federal deficit. The Congressional Budget Office estimates that every 1% increase in unemployment costs the Treasury $25 billion -- $19 billion in lost revenue and $6 billion in new expenditures to pay for unemployment programs.

Of all the housing cycles since the end of World War II, this downturn is the longest and the most difficult that the housing industry has ever experienced. If something is not done soon to open up new sources of mortgage investment capital and to bring down high interest rates, contractors will continue to go under in significant numbers and the numbers which I have cited today will rise exponentially.

Another aspect of this problem involves the current movement to eliminate the distinction between savings and loan associations banks. Savings and loans have historically been the single major

source of long-term stable mortgage funds. The restructuring of these financial institutions will jeopardize the ability of thrift institutions to continue to be a source of stable, long-term mortgage financing. Pension funds, both private and public sector funds, represent the largest source of long-term capital with current assets of approximately $600 billion. Today pension funds invest only about 3% of their assets in mortgages including commercial mortgages. Since pension funds in the future will be the only stable source of long-term mortgage money it is imperative to the housing industry and the American economy that unnecessary legal impediments to mortgage investments by pension funds be removed.

For these reasons, NAHB is grateful for the opportunity to present its views on legislation that will begin to solve these problems by removing artificial barriers created under our pension laws that have substantially inhibited the nation's employee pension funds from investing in home mortgages. The severe plight of the housing industry requires immediate action from Congress. Further, NAHB submits that these actions should be taken at the same time that Congress moves toward restructuring thrift institutions.

ERISA Sections 404 through 408 establish standards were designed to: (1) encourage safe and sound investments yielding acceptable returns that are in the best interests of the plan participants, and (2) protect pension plan participants from improper dealings by plan fiduciaries and other parties-in-interest.

The Congressional assumption behind the adoption of these provisions in 1974 was that dealings between pension funds and related parties are inherently subject to abuse. Because it is difficult to

police these types of transactions, Congress enacted a general prohibition on all dealings between funds and related parties. Unlike most investment transactions, mortgage transactions usually involve a large number of parties including not only employers and employees but also builders, developers, unions, mortgage bankers and other types of financial institutions. Because of the large numbers of parties-in-interest typically involved in mortgage transactions, a mortgage investment is more likely to be classified as a prohibited transaction than other types of investments. Plan trustees are inhibited from engaging in such transactions because there is a significant risk that they might inadvertently engage in a prohibited transaction. Thus, as a practical matter, the ERISA prohibited transaction provisions preclude plan investments in mortgages, even if the transactions are prudent, fair and at arm's-length.

In recognition that these overly restrictive prohibition provisions preclude transactions that do not involve abuse, Congress established special administrative procedures for obtaining relief from the prohibited transaction restrictions by petitioning the Labor Department. Unfortunately, these administrative exemption procedures have proven to be largely unworkable. Obtaining a prohibited transactions exemption is extremely difficult. In addition, once it is obtained there are generally burdensome and restrictive conditions required in order for the transaction to be legal.

This point is further illustrated by relating to the Committee the experience we had in seeking and obtaining a class exemption from the Department of Labor regarding residential mortgage transactions.

In June of 1980 the National Association of Home Builders and the National Coordinating Committee on Multiemployer Plans requested the Department of Labor to issue an administrative exemption that would permit plans to invest in residential mortgages under certain conditions. In December of 1981 the Labor Department issued a proposed class exemption for transactions involving certain residential mortgage financing arrangements. This proposed exemption failed to recognize the realities of the mortgage market and was far too restrictive to provide the type of relief required. Last February NAHB and others requested the Department of Labor to substantially modify this proposed exemption. Finally, after almost two years from the date of request, the Department of Labor issued a final Prohibited Transactions Exemption for whole loans, 82-87, an expansion of a mortgage pool Prohibited Transactions Exemption, 81-7, and a plan asset definition regulation.

The final whole loan exemption represents a substantial improvement over the exemption proposed last December. The exemption allows pension funds to go into residential mortgage financing transactions that include direct acquisition, sale or exchange of real estate mortgage loans and the acquisition or disposal of participation or participation interests in such mortgages. However, several conditions are imposed in order for a pension plan to make a mortgage investment.

First, the mortgage loan must be a "recognized mortgage loan" or a participation interest in a loan for purchase of a "residential dwelling unit" which at the time of purchase was eligble through an established program for purchase by the Federal National Mortgage

Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and the Government National Mortgage Association (GNMA). "Residential dwelling unit" is limited to owner-occupued non-farm property comprising one to four dwelling units, including townhouses, condominiums, manufactured housing, co-ops and certain invester owned units.

Second, the decision regarding the mortgage loan commitments, purchases or sale must be made on behalf of the plan by an independent fiduciary which is referred to as a "qualified real estate manager." And third, the loans must be originated directly for the plan or by the origination purchase process by an "established mortgage lender." To be qualified as an "established mortgage lender" the entity must a HUD approved lender, FNMA/FHLMC approved seller/servicer, state finance agency or independent state authority.

While we commend the Labor Department for making substantial improvements in the final exemption 82-87, we must point out, nowever, that the exemption does not provide the flexibility, and therefore relief, that is necessary. Several problems still remain after the issuance of the Exemption. The first and main point is that the Exemption treats mortgage investments as an inferior type of investment. As the accompanying chart demonstrates, mortgages, in fact, have proven to be a superior form of investment, more so than any other common type of investment made by pension plans. Residential mortgages are stable, high yielding, safe and secure (whether they are backed by the full faith and credit of United States government or whether they are backed by private mortgage insurance). Yet the

Department of Labor believes that the only good mortgages are those that can qualify under a FNMA, FHLMC or GNMA program. Mortgages that qualify under these programs only represented about 46% of the total dollar volume of mortgage orginations in 1981. While NAHB is very supportive of FNMA, FHLMC and GNMA mortgage programs and these agencies' functions in the secondary market, limiting investments to these types of mortgages is the equivalent of prohibiting trustees from buying corporate bonds that do not have a AAA rating. Furtner, and perhaps most important, the trustees of a plan cannot by themselves make the decision to invest in residential mortgages but must delegate this decision to a "qualified real estate manager" or indepedent fiduciary. Retaining the services of an independent fiduciary will involve added expense and complication for the plans. More importantly, such a condtion is not required for making decisions on any other type of investment. Under the prudence standards of ERISA the plan trustees are charged with making decisions that are prudent and in the best interests of the plan participants. It the trustees believe that outside investment advice is necessary they will then seek advice. Moreover, the Labor Department's concerns over the appropriateness of the investment should then be adequately solved by requiring satisfactions of the independent fiduciary or the recognized mortgage loan -- requiring both is administrative overkill.

Conventional mortgage backed securities are a relatively new development, with the first security issue being offered in 1977. A mortgage backed security represents a partial interest in a pool of residential mortgages that has been insured either by private mortgage

insurers or by the credit of the issuing institution (such as Bank of America, Mortgage Guaranty Insurance Corporation, etc.). Most have a double A rating by Standard and Poors. Mortgages packaged in a security form are an instrument that pension fund investors can readily understand. With the development of and packaging of more mortgages as mortgage backed securities, we believe that pension funds will find them a very attractive instrument and that a private secondary market will begin to develop. However, again it must be noted that Labor Department regulations only recognize FNMA, FHLMC and GNMA mortgage backed securities as acceptable instruments in which a plan can invest without Labor Department scrutiny. Otherwise, mortgage backed securities packaged and issued through other financial institutions, investment houses or other entitites must follow Labor Department requirements set forth in prohibited transactions exemption 81-7 for mortgage pools.

The mortgage pool exemption provisions require a plan that is investing in a non-agency mortgage backed security to hire an independent fiduciary to approve the purchase of the certificate and pay no more than fair market value for the certificates. When the pool sponsor is a fiduciary with respect to the plan, the value of the certificate purchased by a plan must not exceed 25% of the amount of the issue and 50% of the issue must be acquired by persons independent of the pool sponsor, trustee or insurer.

The structuring of a mortgage backed security is such that each instrument contains safeguards through established mortgage industry practices, laws or insurance against abuse from self-dealing or conflict of interest. Furthermore, the Labor Department rules placing

percentage limitations on pension plan investment in mortgage backed securities restricts the ability of seller/servicers to structure innovative private placements for funds since the seller/servicer will be considered a plan fiduciary. Adequate market safeguards exist to prevent "dumping" of loans into mortgage pools. The effect of the Department of Labor requirements is to put a stamp of approval on only FNMA, FHLMC, and GNMA mortgage backed securities. This is truly a short sighted and unfair opinion by the Department of Labor and puts a cloud of uncertainty around the quality and stability of non-agency conventional mortgage backed securities. When one considers the safeguards of private mortgage insurance, the underlying security inherent in a mortgage and the creditworthiness of the issuer, these certainly are sufficient safeguards and make non-agency conventional mortgage backed securities as good an investment as mortgage backed securities of FNMA, FHLMC and GNMA.

In addition, these restrictions placed on non-agency mortgage backed securities will hinder the ability of a private secondary market to evolve and become a viable national market. The essential element of an effective secondary market is liquidity, the ability and desire of a large number of investors to buy and sell a security. Liquidity is established by generating a sufficient flow of securities over a number of years to create a large pool of investment instruments which are recognized as being similar by the market. Unfortunately, the Labor Department's recent regulatory actions are inhibiting the flow of new conventional mortgage backed securities, postponing the time when total outstanding volume will increase to a level where

the private secondary market will become firmly established as part of the larger capital market. Since the aspect of liquidity seems important to pension funds when considering investment alternatives, it is the opinion of NAHB that the development of a private secondary market would be an objective worth supporting.

As a final note, the Labor Department chose not to extend the Exemptions to multifamily housing, even though requested to do so. The Labor Department rationale for limiting Exemptions 82-87 and 81-7 to single family transactions is that rental housing investment differs both in magnitude and complexity from single family investment. Although this may be true in an elementary sense, it does not follow that mulitifamily housing presents an investment risk of greater magnitude. An investor that has government agency insurance or private mortgage insurance should not be concerned whether the underlying property securing the debt is single family or multifamily. NAHB now faces the necessity of seeking a separate exemption for multifamily housing mortgage investments and will keep our fingers crossed that within a year one will be issued.

As these problems point out, the Exemptions from the Department of Labor did not sufficiently authorize plan trustees to make mortgage investments. The education of the pension fund community as to the qualities, high yields and soundness of mortgage investments has begun. Furthermore, there is reason to believe that those funds and advisers that become familiar with mortgage investments will begin to consider them seriously when making investment decisions. However, all the education in the world is not going to eliminate the burdens and discentives that Department of Labor guidelines impose on plan invest-

ments in residential mortgages. We believe only Congress can provide the necessary relief by rewriting some of the overly strict provisions that were incorporated in ERISA in 1974.

LEGISLATIVE RELIEF

Given the problems outlined above, there is a clear, immediate and urgent need for Congress to enact legislation that will remove the artificial barriers that effectively block plan trustees from investing in mortgages. The legislation should remove the second class investment status that has been assigned to mortgages. The mortgages that plan trustees acquire should not be circumscribed to a particular class of mortgages, but rather the trustees should be free to acquire any mortgages that they feel are financially sound. If trustees feel that mortgages, other than those outlined in the Exemption, are suitable investments, just as if the trustees wish to acquire stock other than blue chip securities, the trustees should be free to do so in their best judgment. Further, under ERISA the trustees are given the responsibility and authority to direct and control the investment of plan assets. The trustees should also have this responsibility for mortgage investments, thereby avoiding the added expense and burden of having to retain an outside specialist to make one class of plan investments.

All of these changes should be made in a way that will streamline the ability of plan trustees to make investments into residential mortgages. Just as there is no need for added layers of protection to guard against plan trustees abusing their authority when they purchase securities, bonds or other corporate instruments,

there should be no need for artificial restrictions and burdens for plan trustees that wish to invest in residential mortgages.

S.2918, the Residential Mortgage Investment Act of 1982, provides the necessary relief to allow greater freedom for pension plans to invest in residential mortgages. The bill authorizes plans to engage in "qualified mortgage transactions" or to participate in mortgage pools. "Qualified mortgage transactions", as defined in the legislation, include ordinary business transactions such as: the issuance of commitments to provide mortgage financing to purchasers of residential dwelling units; receiving a fee for issuing a commitment; orginating or purchasing a mortgage loan or participation interest in such a loan whether directly or pursuant to a commitment; sale or exchange of a mortgage loan or a participation interest in a mortgage loan; providing services incidential to a mortgage loan such as collecting mortgage payments, taxes and insurance premiums; the purchase, sale or commitment to sell a mortgage backed security; and forming and operating a pool or pools of mortgage loans.

Specifically, the bill permits plans to engage in "qualified mortgage transactions" involving "qualified mortgage loans" provided the transactions are prudent and at arm's-length. To accomplish this, the bill exempts the qualified mortgage transactions from a portion of the prohibited transactions provisions of the Employee Retirement Income Security Act, the Internal Revenue Code of 1954 any any contrary provisions of state law. The bill allows participation in mortgage pools and the acquisition of participation interests in residential mortgages. In short, the bill permits plans to acquire

and sell mortgages under the same general standards applicable to other plan investments.

While the bill does not expressly state that the mortgage investment decisions must be made following a prudence rule, residential mortgage investments are not exempt from Section 404 of ERISA, the prudence standards. This means that plan trustees and fiduciaries must consider mortgage investments in light of current ERISA prudence standards. In addition, Section 406(b), the selfdealing provision of the prohibited transactions section of ERISA, also remains intact. Thus plan trustees will not be able to engage in mortgage transactions for their own benefit.

Finally, S.2918 does not mandate pension plans to invest in mortgages or even to consider residential mortgages as an investment alternative. The bill only removes existing regulatory and statutory barriers to residential mortgage investment. NAHB believes that the removal of these restrictions will be an incentive to funds to consider residential mortgages as an alternative investment. Furthermore, when pension plan trustees and advisors evaluate residential mortgages and mortgage backed securities and compare their safety, soundness and high yields to other investments, we believe the plan trustees will make residential mortgages part of their plan investment portfolio. If private pension plans increase their investments in residential mortgages by only one percent, that would result in an additional $30 billion available for residential mortgage financing. This new infusion of mortgage capital in the market has the potential of putting downward pressure on mortgage interest rates, which could lead to a recovery for housing and the whole United States economy.

In conclusion, NAHB strongly urges this Subcommittee to take immediate action to report S.2918 out of the Finance Committee and bring it before the full Senate for consideration and passage this year. Nothing short of immediate legislative action will allow residential mortgages to be considered on an equal basis with alternative investments.

Thank you for the opportunity to present our views on this issue. I will be pleased to answer any questions you may have.

SELECTED INTEREST RATES AND YIELDS, 1970-81

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1970-1981 Aver.
6 Month T-Bill, Secondary mkt.	6.51%	4.52%	4.49%	7.20%	7.95%	6.11%	5.26%	5.53%	7.58%	10.06%	11.37%	13.80%	7.53%
12 Month T-Bill, Secondary mkt.	6.49	4.67	4.77	7.01	7.71	6.30	5.52	5.71	7.74	9.75	10.89	13.14	7.48
Moody Aaa	6.12	5.22	5.04	4.99	5.89	6.42	5.66	5.20	5.52	5.92	7.85	10.43	6.19
Moody Baa	6.75	5.89	5.60	5.49	6.53	7.62	7.49	6.12	6.27	6.73	9.01	11.76	7.11
20 Year Treasury Bonds	-	-	-	-	8.05	8.19	7.86	7.67	8.48	9.33	11.39	13.72	-
30 Year Treasury Bonds	-	-	-	-	-	-	-	-	8.49	9.29	11.30	13.44	-
Dividend/Price Ratio													
Preferred Stocks	7.22	6.75	7.27	7.23	8.23	8.38	7.97	7.60	8.25	9.07	10.57	12.36	8.41
Common Stocks	3.83	3.14	2.84	3.06	4.47	4.31	3.77	4.56	5.28	5.46	5.25	5.41	4.28
FNMA Auctions													
Government Underwritten Loans	9.00	7.82	7.64	8.78	9.53	9.31	8.99	8.73	9.77	11.17	14.11	16.70	10.13
Conventional Loans	-	-	7.82	8.82	9.70	9.36	9.11	8.98	10.01	11.77	14.43	16.64	-
FHLBB Effective Rate													
Newly Built Homes	8.45	7.74	7.60	7.96	8.93	9.02	9.00	9.01	9.54	10.77	12.65	14.77	9.62
Previously Occupied Homes	8.36	7.67	7.51	8.02	9.04	9.21	9.11	9.02	9.58	10.92	12.95	15.12	9.71
All Homes	8.38	7.69	7.53	8.00	9.00	9.16	9.08	9.02	9.56	10.87	12.86	14.99	9.66

Source: Federal Reserve Board. Federal National Mortgage Association. Federal Home Loan Bank Board

PRIVATE PENSION FUND ASSETS AND LIABILITIES, 1949-1981
(in billions of dollars)

	Total Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	Treasury Issues	Agency Issues	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	$ 5.4	$0.2	$ 0.0	$ 0.6	$ 4.2	$ 2.2	$0.0	$ 1.9	$0.1	$0.4
1950	7.1	0.3	0.0	1.1	5.3	2.3	0.0	2.8	0.1	0.4
1951	8.2	0.3	0.0	1.4	6.0	2.4	0.0	3.5	0.1	0.4
1952	9.8	0.3	0.0	1.8	7.2	2.5	0.0	4.5	0.1	0.5
1953	11.7	0.4	0.0	2.4	8.5	2.6	0.0	5.6	0.2	0.5
1954	13.8	0.4	0.0	3.2	9.8	2.7	0.0	6.9	0.2	0.5
1955	18.3	0.4	0.0	6.1	11.2	3.0	0.0	7.9	0.3	0.7
1956	21.1	0.4	0.0	7.1	12.7	2.8	0.0	9.5	0.4	0.9
1957	23.4	0.5	0.0	7.5	14.5	2.5	0.1	11.3	0.6	1.0
1958	29.2	0.5	0.0	11.6	16.2	2.5	0.1	12.8	0.7	1.0
1959	34.1	0.5	0.0	14.5	17.9	2.6	0.2	14.1	1.0	1.2
1960	38.1	0.5	0.0	16.5	19.7	2.4	0.3	15.7	1.3	1.4
1961	46.1	0.7	0.0	22.9	21.2	2.4	0.3	16.9	1.6	1.5
1962	47.2	0.7	0.0	21.9	22.9	2.6	0.3	18.1	1.9	1.7
1963	55.0	0.8	0.0	27.7	24.8	2.7	0.4	19.6	2.2	1.7
1964	64.3	0.9	0.0	33.7	27.2	2.7	0.5	21.2	2.8	2.5
1965	73.6	0.9	0.0	40.8	29.1	2.5	0.5	22.7	3.4	2.9
1966	75.8	0.8	0.1	39.5	31.9	2.3	0.4	25.2	3.9	3.5
1967	89.4	0.9	0.4	51.1	32.8	2.0	0.3	26.4	4.1	4.2
1968	101.5	1.0	0.6	61.5	33.8	2.4	0.4	27.0	4.1	4.6
1969	102.4	1.0	0.6	61.4	34.6	2.2	0.6	27.6	4.2	4.7
1970	110.4	1.1	0.7	67.1	36.6	2.1	0.9	29.4	4.2	4.9
1971	130.1	1.3	0.3	88.7	35.0	2.1	0.6	28.6	3.7	4.8
1972	156.1	1.6	0.3	115.2	34.0	3.0	0.7	27.6	2.7	5.0
1973	134.3	1.4	1.1	90.5	36.3	3.1	1.3	29.5	2.4	5.1
1974	115.5	1.3	3.7	63.3	41.9	3.0	2.6	34.0	2.4	5.3
1975	146.8	1.5	2.4	88.6	48.9	7.4	3.3	35.8	2.4	5.5
1976	171.9	1.6	2.3	109.7	52.5	11.1	3.6	35.5	2.4	5.7
1977	178.5	1.7	4.8	101.9	65.0	15.9	4.2	42.1	2.7	5.2
1978	198.6	1.8	10.3	107.9	73.3	17.5	4.7	48.0	3.1	5.4
1979	222.4	1.9	8.9	123.7	82.2	19.4	5.6	53.7	3.5	5.8
1980	286.1	1.9	11.3	171.1	95.6	23.5	8.1	60.1	4.0	6.2
1981	293.2	2.0	12.0	167.1	105.5	30.6	9.3	61.7	3.8	6.6

Note: Private noninsured pension fund assets have been underestimated by at least $100 billion per year in each year since 1977, according to a recent Department of Labor study. The new figures were derived from a study of 37,500 pension plans, based on IRS Form 5500 reports in 1977. The SEC is currently revising its figures and intends to publish new figures in the near future.

Source: Federal Reserve Board

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PRIVATE PENSION FUND ASSETS AND LIABILITIES, 1949-1981
(Percent Distribution)

	Total Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	Treasury Issues	Agency Issues	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	100.0%	3.8%	0.0%	10.9%	78.1%	41.9%	0.0%	34.7%	1.5%	7.1%
1950	100.0	3.7	0.0	15.7	74.8	33.2	0.0	40.1	1.4	5.8
1951	100.0	4.0	0.0	16.6	74.0	29.9	0.0	42.6	1.5	5.4
1952	100.0	3.1	0.0	18.7	72.9	25.2	0.0	46.2	1.5	5.2
1953	100.0	3.1	0.0	20.4	72.3	22.4	0.2	48.1	1.6	4.2
1954	100.0	2.6	0.0	22.8	71.0	19.3	0.1	49.9	1.7	3.6
1955	100.0	2.3	0.0	33.2	60.9	16.2	0.1	42.8	1.8	3.7
1956	100.0	2.0	0.0	33.5	60.3	13.0	0.2	44.9	2.1	4.3
1957	100.0	2.0	0.0	32.0	61.8	10.5	0.5	48.4	2.5	4.2
1958	100.0	1.7	0.0	39.6	55.3	8.4	0.4	43.9	2.5	3.5
1959	100.0	1.6	0.0	42.6	52.4	7.7	0.6	41.3	2.9	3.4
1960	100.0	1.4	0.0	43.4	51.6	6.3	0.7	41.2	3.4	3.6
1961	100.0	1.4	0.0	49.5	45.9	5.3	0.6	36.6	3.4	3.2
1962	100.0	1.5	0.0	46.4	48.6	5.5	0.7	38.4	4.0	3.5
1963	100.0	1.4	0.0	50.3	45.1	4.9	0.7	35.6	4.0	3.2
1964	100.0	1.4	0.0	52.4	42.3	4.2	0.7	33.0	4.3	3.9
1965	100.0	1.3	0.0	55.3	39.5	3.4	0.6	30.8	4.6	3.9
1966	100.0	1.0	0.2	52.1	42.1	3.0	0.6	33.3	5.2	4.6
1967	100.0	1.0	0.5	57.2	36.6	2.2	0.4	29.5	4.6	4.7
1968	100.0	1.0	0.6	60.6	33.3	2.3	0.4	26.6	4.0	4.5
1969	100.0	1.0	0.6	60.0	33.8	2.1	0.6	27.0	4.1	4.6
1970	100.0	1.0	0.6	60.8	33.2	1.9	0.8	26.7	3.8	4.4
1971	100.0	1.0	0.3	68.1	26.9	1.6	0.5	22.0	2.8	3.7
1972	100.0	1.0	0.2	73.8	21.8	1.9	0.5	17.7	1.7	3.2
1973	100.0	1.0	0.8	67.4	27.0	2.3	0.9	21.9	1.8	3.8
1974	100.0	1.2	3.2	54.8	36.3	2.6	2.2	29.4	2.1	4.6
1975	100.0	1.0	1.6	60.3	33.3	5.1	2.3	24.3	1.6	3.8
1976	100.0	0.9	1.4	63.8	30.6	6.5	2.1	20.6	1.4	3.3
1977	100.0	0.9	2.7	57.1	36.4	8.9	2.4	23.6	1.5	2.9
1978	100.0	0.9	5.2	54.3	36.9	8.8	2.4	24.2	1.5	2.7
1979	100.0	0.9	4.0	55.6	37.0	8.7	2.5	24.1	1.6	2.6
1980	100.0	0.7	3.9	59.8	33.4	8.2	2.8	21.0	1.4	2.2
1981	100.0	0.7	4.1	57.0	36.0	10.4	3.2	21.0	1.3	2.3

Note: Private noninsured pension fund assets have been underestimated by at least $100 billion per year in each year since 1977, according to a recent Department of Labor study. The new figures were derived from a study of 37,500 pension plans, based on IRS Form 5500 reports in 1977. The SLC is currently revising its figures and intends to publish new figures in the near future.

Source: Federeal Reserve Board

PRIVATE PENSION FUNDS ANNUAL FLOWS, 1949-1981
(in millions of dollars)

	Net Acquisition of Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	U.S. Government Issues	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	$ 636	$ 43	$ 0	$ 124	$ 589	$ 250	$ 319	$ 20	$-120
1950	1,694	60	0	519	1,085	100	965	20	30
1951	1,121	65	0	253	773	100	655	18	30
1952	1,658	-19	0	478	1,127	33	1,065	29	72
1953	1,901	56	0	545	1,319	177	1,099	43	-19
1954	2,041	-9	0	709	1,333	27	1,260	46	8
1955	2,309	58	0	739	1,339	310	946	83	173
1956	2,727	0	0	941	1,557	-193	1,622	128	229
1957	3,040	51	0	1,135	1,772	-224	1,862	134	82
1958	3,101	30	0	1,381	1,656	-8	1,505	159	34
1959	3,663	39	0	1,743	1,734	244	1,243	247	147
1960	3,961	11	0	1,946	1,798	-128	1,614	312	206
1961	3,939	114	0	2,258	1,474	32	1,183	259	93
1962	4,181	47	0	2,198	1,745	210	1,219	316	191
1963	4,253	66	0	2,170	1,927	124	1,459	344	90
1964	5,468	119	0	2,212	2,348	144	1,646	558	789
1965	5,411	49	0	3,124	1,905	-199	1,497	607	333
1966	6,899	-183	142	3,479	2,811	-243	2,528	526	650
1967	6,562	136	283	4,562	869	-427	1,124	172	712
1968	6,509	121	152	4,822	1,061	432	645	-16	353
1969	6,342	9	18	5,382	798	36	613	149	135
1970	6,913	82	103	4,566	2,022	237	1,830	-45	140
1971	7,079	199	-362	8,915	-1,639	-297	-829	-513	-34
1972	6,652	262	-46	7,285	-993	957	-1,020	-930	157
1973	8,265	-215	794	5,290	2,250	715	1,887	-352	146
1974	10,702	-15	2,665	2,305	5,613	1,129	4,488	-4	134
1975	11,814	115	-1,339	5,772	7,023	5,231	1,781	11	243
1976	11,234	123	-78	7,302	3,647	3,949	-289	-13	240
1977	17,682	95	2,474	4,460	11,159	5,425	5,369	365	-506
1978	19,629	92	5,497	5,332	8,582	2,105	5,904	573	126
1979	21,100	100	-1,400	13,100	8,900	2,800	5,700	500	400
1980	22,300	100	1,400	9,600	10,800	5,800	4,400	600	400
1981	22,500	100	1,800	7,300	12,900	9,100	3,600	100	400

Source: Federal Reserve Board

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ASSETS AND LIABILITIES, 1949-1981
(in billions of dollars)

	Total Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	$ 4.2	$0.1	$ 0.0	$ 4.1	$ 2.3	$ 2.3	$ 0.0	$1.3	$ 0.4	$0.1
1950	4.9	0.1	0.0	4.7	2.5	2.5	0.0	1.5	0.6	0.1
1951	5.6	0.1	0.0	5.4	2.9	2.9	0.0	1.7	0.7	0.1
1952	6.6	0.2	0.1	6.4	3.4	3.4	0.0	1.9	1.0	0.1
1953	8.0	0.2	0.1	7.7	3.9	3.9	0.0	2.1	1.5	0.2
1954	9.5	0.2	0.1	9.2	4.4	4.4	0.0	2.4	2.1	0.2
1955	10.8	0.2	0.2	10.5	4.7	4.7	0.1	2.7	2.7	0.3
1956	12.1	0.2	0.2	11.7	5.0	4.9	0.1	3.1	3.2	0.4
1957	13.8	0.2	0.3	13.3	5.2	5.1	0.1	3.5	4.0	0.5
1958	15.6	0.2	0.4	15.0	5.1	5.0	0.1	4.0	5.1	0.7
1959	17.6	0.2	0.5	16.8	5.6	5.5	0.1	4.3	6.0	1.0
1960	19.7	0.2	0.6	18.9	5.9	5.7	0.2	4.4	7.1	1.5
1961	22.3	0.3	0.9	21.1	6.1	5.8	0.3	4.3	8.9	1.9
1962	24.5	0.3	1.0	23.2	6.5	6.1	0.4	3.8	10.7	2.2
1963	27.4	0.3	1.5	25.6	6.9	6.5	0.3	3.3	12.8	2.6
1964	30.6	0.3	2.0	28.3	7.4	7.0	0.4	2.9	14.9	3.1
1965	34.1	0.3	2.5	31.3	7.6	7.2	0.5	2.6	17.2	3.7
1966	38.1	0.4	2.8	34.9	7.8	7.1	0.7	2.5	20.2	4.5
1967	42.6	0.5	3.9	38.3	7.0	6.2	0.8	2.4	23.9	5.0
1968	48.0	0.6	5.8	41.6	7.3	5.9	1.4	2.4	26.6	5.4
1969	53.2	0.5	7.3	45.5	7.0	5.4	1.6	2.3	30.6	5.6
1970	60.3	0.6	10.1	49.6	6.6	5.1	1.5	2.0	35.1	5.9
1971	69.0	0.7	15.4	52.9	5.4	3.9	1.5	2.2	39.0	6.3
1972	80.6	1.0	22.2	57.4	5.7	3.6	2.1	2.0	43.2	6.5
1973	84.7	1.3	20.2	63.1	5.8	2.5	3.3	1.7	48.4	7.1
1974	88.0	1.8	16.4	69.8	6.2	1.6	4.6	1.0	54.9	7.7
1975	104.8	1.4	24.3	79.1	7.8	2.5	5.3	1.9	61.8	7.5
1976	120.6	1.4	30.1	89.1	10.9	4.1	6.8	3.4	67.1	7.7
1977	132.6	1.7	30.0	100.9	16.5	6.6	9.8	3.5	72.7	8.2
1978	153.0	2.8	33.3	116.9	22.8	10.5	12.4	4.0	81.4	8.7
1979	170.1	4.0	37.1	129.0	29.7	13.5	16.3	3.9	86.0	9.4
1980	202.7	4.1	54.2	144.5	39.5	17.5	22.0	4.0	91.1	9.9
1981	221.3	5.4	47.8	168.1	48.6	27.3	21.3	4.0	102.8	12.7

Source: Federal Reserve Board

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ASSETS AND LIABILITIES, 1949-1981
(Percent Distribution)

	Total Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	100.0%	2.4%	0.5%	97.1%	54.0%	54.0%	0.0%	32.3%	9.6%	1.2%
1950	100.0	2.5	0.6	97.0	51.5	51.5	0.0	31.9	12.0	1.5
1951	100.0	2.5	0.7	96.8	52.0	52.0	0.0	30.5	12.5	1.9
1952	100.0	2.4	0.8	96.8	51.1	50.8	0.3	28.3	15.2	2.1
1953	100.0	2.4	0.9	96.7	48.8	48.5	0.3	26.4	19.2	2.4
1954	100.0	2.1	1.0	96.9	46.8	46.4	0.4	25.1	22.4	2.6
1955	100.0	1.6	1.8	96.5	43.6	43.1	0.5	25.1	24.9	2.9
1956	100.0	1.6	1.7	96.8	41.5	41.0	0.6	25.8	26.2	3.3
1957	100.0	1.7	2.2	96.1	37.4	36.7	0.7	25.7	29.2	3.9
1958	100.0	1.6	2.6	95.9	32.9	32.2	0.7	25.4	32.8	4.7
1959	100.0	1.3	2.8	95.9	31.9	31.1	0.8	24.2	34.1	5.6
1960	100.0	1.2	3.0	95.7	29.9	28.9	1.0	22.3	36.1	7.3
1961	100.0	1.2	4.0	94.7	27.3	26.1	1.2	19.2	39.8	8.5
1962	100.0	1.3	4.1	94.7	26.5	24.9	1.6	15.5	43.5	9.1
1963	100.0	1.1	5.5	93.4	25.1	23.8	1.3	12.1	46.7	9.5
1964	100.0	1.0	6.5	92.5	24.2	22.9	1.2	9.5	48.8	10.0
1965	100.0	0.9	7.3	91.7	22.4	21.0	1.4	7.7	50.6	11.0
1966	100.0	1.0	7.3	91.7	20.4	18.7	1.7	6.5	53.0	11.8
1967	100.0	1.1	9.1	89.8	16.3	14.5	1.8	5.6	56.1	11.7
1968	100.0	1.3	12.1	86.7	15.3	12.3	2.9	5.0	55.3	11.2
1969	100.0	0.9	13.7	85.4	13.2	10.2	2.9	4.4	57.4	10.5
1970	100.0	1.0	16.7	82.3	10.9	8.5	2.5	3.4	58.1	9.8
1971	100.0	1.0	22.3	76.7	7.9	5.6	2.2	3.1	56.5	9.1
1972	100.0	1.2	27.5	71.3	7.1	4.5	2.6	2.5	53.6	8.0
1973	100.0	1.6	23.9	74.6	6.9	3.0	3.9	2.0	57.2	8.4
1974	100.0	2.0	18.6	79.3	7.0	1.8	5.2	1.1	62.4	8.8
1975	100.0	1.4	23.2	75.4	7.4	2.4	5.0	1.9	58.9	7.2
1976	100.0	1.2	25.0	73.9	9.0	3.4	5.7	2.8	55.6	6.4
1977	100.0	1.3	22.6	76.1	12.4	5.0	7.4	2.7	54.8	6.2
1978	100.0	1.8	21.8	76.4	14.9	6.8	8.1	2.6	53.2	5.7
1979	100.0	2.4	21.8	75.8	17.5	7.9	9.6	2.3	50.6	5.5
1980	100.0	2.0	26.7	71.3	19.5	8.6	10.9	2.0	44.9	4.9
1981	100.0	2.4	21.6	76.0	22.0	12.3	9.6	1.8	46.5	5.7

Source: Federal Reserve Board

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ANNUAL FLOWS, 1949-1981
(in millions of dollars)

	Net Acquisition of Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	$ 536	$ 10	$ 7	$ 519	$ 184	$ 184	$ 0	$ 183	$ 135	$ 17
1950	674	18	9	647	241	241	0	200	183	23
1951	760	19	12	729	420	420	0	163	116	30
1952	1,027	20	15	992	476	456	20	171	309	36
1953	1,324	31	19	1,274	491	486	5	220	516	47
1954	1,488	5	24	1,459	536	523	13	273	589	61
1955	1,304	-20	28	1,296	303	283	20	347	577	69
1956	1,274	16	34	1,224	287	278	9	387	473	77
1957	1,675	47	51	1,577	144	114	30	429	859	145
1958	1,770	7	58	1,705	-17	-37	20	424	1,102	196
1959	1,926	-23	75	1,874	470	441	29	288	860	256
1960	2,158	22	86	2,050	299	249	50	155	1,138	458
1961	2,381	34	152	2,195	164	89	75	-143	1,728	446
1962	2,356	30	197	2,129	424	300	124	-459	1,818	346
1963	2,560	6	209	2,345	362	410	-48	-500	2,113	370
1964	3,040	-2	273	2,769	554	520	34	-404	2,161	458
1965	3,294	6	352	2,936	234	123	111	-275	2,301	676
1966	4,226	51	488	3,687	122	-38	160	-144	2,939	770
1967	4,093	91	670	3,332	-817	-950	133	-75	3,737	487
1968	4,820	143	1,317	3,360	381	-244	625	-24	2,644	359
1969	5,488	-128	1,788	3,828	-328	-484	156	-51	3,994	213
1970	6,393	122	2,137	4,134	-408	-333	-75	-299	4,496	345
1971	6,554	95	3,185	3,274	-1,155	-1,208	53	120	3,941	368
1972	8,491	262	3,677	4,552	262	-299	561	-123	4,231	182
1973	9,480	386	3,411	5,683	140	-1,089	1,229	-338	5,210	671
1974	9,697	453	2,569	6,675	326	-923	1,249	-708	6,496	561
1975	11,307	-351	2,388	9,270	1,626	955	671	957	6,847	-160
1976	12,900	--	3,100	9,800	3,100	1,500	1,600	1,400	5,100	200
1977	15,900	300	3,700	11,900	5,500	2,700	2,700	200	6,000	300
1978	20,700	1,000	2,600	17,000	7,100	2,700	4,400	400	9,000	500
1979	16,200	1,300	4,100	10,800	6,600	5,300	1,400	--	3,200	1,000
1980	26,500	600	5,300	20,600	9,400	6,200	3,200	100	9,700	1,300
1981	27,300	800	7,600	18,900	9,100	6,400	2,700	--	8,000	1,800

Source: Federal Reserve Board

STATEMENT OF DOUGLAS E. JOHNSON, VICE PRESIDENT, CHASE HOME MORTGAGE CORP., MONTVALE, N.J., ON BEHALF OF MORTGAGE BANKERS ASSOCIATION OF AMERICA, WASHINGTON, D.C.

Senator CHAFEE. Mr. Johnson.

Mr. JOHNSON. Mr. Chairman, my name is Doug Johnson. I am a vice president of Chase Home Mortgage Corp. of Montvale, N.J., a subsidiary of the Chase Manhattan Corp. I am testifying today, though, in my capacity as the chairman of the New Investor Opportunities Subcommittee of the Mortgage Bankers Association of America. Appearing with me is Bill Cumberland, MBA's general counsel.

We appreciate the opportunity to appear before you to testify on the desirability of pension fund investment in mortgages and on the impediments to such investments that are imposed by the Employees Retirement Income Security Act.

We know, Mr. Chairman, that you appreciate the importance of removing the barriers to the free flow of investor dollars to real estate finance. And conversely, the benefit of providing pension managers with as broad a spectrum of investment opportunities as possible. The legislation which you, along with Senators Matsunaga, Mitchell, and others, introduced on September 16, S. 2918, the Residential Mortgage Investment Act of 1982, is a giant stride toward those ends.

MBA supports enactment of the Residential Mortgage Investment Act or similar legislation, which would remove the burdens of the prohibited transaction rule from investments made by pension funds which are in accord with the customary practices of the residential mortgage industry. We mortgage bankers do business in a market where customary practices are as well developed as in any other investment market. These, plus the prudent investor standard as embodied in ERISA, and not affected by S. 2918, will provide adequate assurance that the funds will be carefully managed, while at the same time maximizing investment and housing opportunities.

The structure of ERISA interferes with pension fund investment in both commercial real estate and residential property. Because the housing industry is in a dire economic condition and has immense potential need for financing, pension investment in residential property has received special attention by the administration, and is appropriately the subject of the bill you have introduced.

Senator CHAFEE. Now, Mr. Cumberland, you have 14 pages here.

Mr. JOHNSON. We have five, sir. We have cut it down to an oral statement.

Senator CHAFEE. Mr. Johnson. I'm sorry. You've got it in five?

Mr. JOHNSON. Yes, sir. We've got a summary here.

Senator CHAFEE. Go ahead.

Mr. JOHNSON. On May 14, the Department of Labor [DOL] made public a series of rulings affecting the pension plan investment in residential mortgages. DOL was responding to a request for a class exemption for mortgages submitted to them in 1980, and to repeated requests of labor and industry, as well as the President's Commission on Housing and President Reagan himself.

The rulings appear to make a start toward freeing up pension funds for investment in mortgages on newly constructed and also on already existing houses. MBA and the mortgage banking industry applauded the Department for attentive and earnest efforts to develop a rule under which the market can function in a healthy manner. However, the rules contain inherent flaws, which S. 2918 would overcome.

The demand for housing that is expected to occur in the 1980's will require a tremendous amount of capital. At the end of 1980, the outstanding mortgage debt stood at $1.1 trillion. By 1990, it is believed that that number could triple. I don't think it's important what number we use for 1990, just suffice it to say that the needs are tremendous in the future for housing in this country.

Pension funds control an increasing share of American capital, and so, they must be tapped if sufficient funds are to be made available to housing. In addition, because they consist of long-term stable funds with an obligation to pay an annuity in the future, pension funds are ideally suited to mortgage investments. Public pension firms, that is, those serving State and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mortgage investments of $190 million in 1976, almost $700 million in 1978, and $1.3 billion in 1980. The mortgage holdings reached $12 billion by September 1981—the latest date for which we have any figures. Private pension fund investment has been so small as to be almost nonexistent. MBA believes this lack of investment is in part due to the fact that the effects of ERISA are so inhibiting on these kinds of transactions.

As I have said before, the rulings of the Department of Labor were helpful but their approach provides serious impediments to the mortgage market. Unlike other forms of investment, the new rules saddle mortgage investment with the mandatory cost of hiring a real estate investment adviser, even where the trustees are themselves knowledgeable. Not only does this place mortgages at a competitive disadvantage, it clearly indicates that they are second-class investments in the eyes of the Department of Labor. Additionally, in both the whole loan exemption and the plan asset rule, the Department of Labor has adopted mortgage standards of the Federal National Mortgage Association [FNMA], the Federal Home Loan Mortgage Corporation [FHLMC], and the Government National Mortgage Association [GNMA].

Fannie Mae, Freddy Mac, and Ginnie Mae were created by Federal statute, and each was created for a purpose other than defining what kind of mortgage investments a pension plan should invest in. Each has limits on the dollar amount of any individual mortgage they may purchase.

For example, Fannie Mae and Freddy Mac may not buy a mortgage with a principal balance of more than $107,000. They also have an aggregate dollar activity limit controlled by Federal Government officials. There is no question that these instrumentalities have proven knowledgeable and successful in the mortgage markets. However, the standards which they have developed and those which Congress has imposed accomplish their purposes but do not necessarily serve the needs of pension plans.

If I might digress for a second: I would like to point out that I have placed mortgage passthroughs with public pension funds and in the most recent transactions I did—we had several mortgages in the pool in excess of $107,000. The largest, in fact, was $150,000. That pool was rated double A. And the investor is very pleased with it. That's by way of example.

Minor changes in the Department of Labor's class exemptions will not remove the inherent characteristics of treating mortgages as second-class investments. S. 2918 would clear away this competitive disadvantage and might encourage pension plan investment in the highly sophisticated and rapidly developing real estate financial market.

The MBA appreciates the opportunity to appear before you, before the subcommittee, and would be happy to furnish any additional information you might need.

Thank you, sir.

Senator CHAFEE. Well, thank you, Mr. Johnson.

[The prepared statement of Douglas E. Johnson follows:]

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Washington, D.C. 20005
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Mortgage Bankers Association of America

STATEMENT OF

DOUGLAS E. JOHNSON

VICE PRESIDENT
CHASE HOME MORTGAGE COMPANY
MONTVALE, NEW JERSEY

on behalf
of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

of the

COMMITTEE ON FINANCE

UNITED STATES SENATE

Hearings on

S 2918, "The Residential Mortgage Investment Act of 1982"

September 27, 1982

Mr. Chairman and Members of the Subcommittee, my name is Douglas E. Johnson. I am Vice President of Chase Home Mortgage Company of Montvale, New Jersey, a subsidiary of the Chase Manhattan Corporation. I am testifying today in my capacity as Chairman of the New Investor Opportunities Subcommittee of the Mortgage Bankers Association of America.* Appearing with me is William E. Cumberland, MBA's General Counsel.

We appreciate the opportunity to appear before you to testify on the desirability of pension fund investment in mortgages, and on the impediments to such investments that are imposed by the Employees Retirement Income Security Act (ERISA). ERISA has had the effect of inhibiting pension plan trustees and pension plan managers from making investments in mortgages, mortgage-backed securities, and other forms of real estate assets that can provide attractive returns for pension funds and provide the diversity that prudent investing and ERISA require.

We know, Mr. Chairman, that you appreciate the importance of removing the barriers to the free flow of investor dollars to real estate finance, and conversely, the benefit of providing pension managers with as broad a spectrum of investment opportunities as possible. The legislation which you, along with Senators Matsunaga, Mitchell, and others,

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- o Mortgage Banking Companies
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Pension Funds
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

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introduced September 16, S 2918, The Residential Mortgage Investment Act of 1982, is a giant stride toward those ends.

MBA supports enactment of the Residential Mortgage Investment Act or similar legislation, which would remove the burdens of the prohibited transaction rule from investments made by pension funds in accordance with customary practices in the residential mortgage industry. We do business in a market where customary practices are as well developed as in any other investment market. These, plus the prudent investor standard as embodied in ERISA, and not affected by S 2918, will provide adequate assurance that the funds will be carefully managed, while at the same time maximizing investment and housing opportunities.

The structure of ERISA interferes with pension fund investment in both commercial real estate and residential properties. Because the housing industry is in a dire economic condition and has immense potential needs for financing, pension investment in residential property has received special attention by the Administration, and is appropriately the subject of the bill you have introduced.

On May 14, the Department of Labor (DOL) made public a series of rulings affecting pension plan investment in residential mortgages. DOL was responding to a request for a class exemption for mortgages, submitted to them in 1980, and to repeated requests of labor and industry, as well as the President's Housing Commission and President Reagan himself. Two of the rulings are class exemptions from the prohibited transactions provisions of ERISA. The third is a final interpretive regulation defining the term "plan assets" in the context of mortgage-backed securities and other pools of home mortgages.

The rulings appear to make a start toward freeing up pension funds for investment in mortgages on newly constructed and also on already existing houses. MBA and the mortgage banking industry applauded the Department for attentive and earnest efforts to develop a rule under which the market can function in a healthy manner. However, the rules contain inherent flaws, which S 2918 would overcome.

Fundamental changes that are occurring in the way housing is financed in this country should present new investment opportunities for pension funds. A combination of factors has severely reduced the effectiveness of the old mortgage finance system, which relied heavily on mortgage investment by savings and loans and other thrift institutions. While in the future, thrifts may specialize in consumer and/or real estate lending, they will not hold long-term loans, such as mortgages, in portfolio to the extent they have in the past. This will create a home financing gap. Mortgages must be packaged and sold to pension funds and others with sources of long-term funds in order to fill that gap.

The demand for housing that is expected to occur in the 1980s will require a tremendous amount of capital. At the end of 1980, outstanding mortgage debt in the United States stood at $1.1 trillion. By 1990, that amount is expected to triple. Raising this volume of funds will require that mortgages be attractive to those who make long-term capital investments, such as pension trustees and managers.

Pension funds control an increasing share of American capital, and so, must be tapped if sufficient funds are to be made available to housing. In addition, because they consist of stable long-term funds with an obligation to pay an annuity in the future, pension funds are ideally suited to mortgage investment. Public pension funds, i.e., those serving state and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mort

gage investments of $190 million in 1976, $679 million in 1978, and $1.3 billion in 1980, with mortgage holdings reaching $12 billion by September 1981, the latest date for which we have figures. However, private pension fund investment has been so small as to be virtually non-existent. MBA believes this lack of investment on the part of private funds can be traced largely to the inhibiting effects of ERISA.

When the Department of Labor (DOL) published Prohibited Transaction Exemption 81-7 last summer, and the proposed whole loan exemption last December, MBA commented extensively, suggesting that each of these exemptions be broadened in recognition of the market. Almost every suggestion MBA made was responded to favorably by DOL in the rules made available May 14, for publication in the May 18, 1982, Federal Register. As published, the new exemptions and the new definition of "plan assets" would appear to allow pension fund managers to enter into the mainstream of residential mortgage investment to the benefit of the pension plans and to the benefit of the housing market and the housing industry.

As recognized by the DOL, these rulings do not remove all the barriers to sound investment by pension plans in real estate. The categories of commercial and industrial properties are not covered. Multifamily residential projects, which are increasingly recognized as an efficient form of housing, are expressly excluded. These types of real estate are providing attractive returns on investment for other institutional investors, and pension plans should be allowed similar investment opportunity.

However, even within the intended reach of these class exemptions, there are serious impediments to the mortgage market. Unlike other forms of investment, the new rules saddle mortgage investment with the mandatory cost of hiring a real estate investment advisor, even where the trustees are themselves knowledgeable. Not only does this place

mortgages at a competitive disadvantage, it clearly indicates they are second class investments in the eye of the Department of Labor. Additionally, in both the whole mortgage exemption and the "plan asset" rule, the DOL has adopted the mortgage standards of the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), and the Government National Mortgage Association (GNMA).

FNMA, FHLMC, and GNMA were created by Federal statute, and each was created for a purpose other than defining what types of mortgage investments pension plans should be making. FNMA and FHLMC are intended to support the secondary market for mortgages for moderate- and middle-income homebuyers, traditionally by purchasing such mortgages when the market requires, and just recently, by guaranteeing securities based on and backed by such mortgages. Each has limits on the dollar amount of any individual mortgage they may purchase. For example, FNMA may not buy a mortgage with a principal balance of more than $107,000. They also have aggregate dollar activity limits controlled by Federal government officials. GNMA is a part of the Department of Housing and Urban Development which currently buys only below-market interest rate multifamily mortgages and guarantees securities based on and backed by mortgages insured or guaranteed by other Federal agencies whose programs are determined by social, as well as market, need. There is no question that these instrumentalities have proven themselves knowledgeable and successful in the mortgage markets. However, the standards they have developed and Congress has imposed to accomplish their purposes do not serve pension plans fully.

ERISA PROVISIONS

In order to assist the Committee in evaluating the favorable effect of the rules published by DOL, and in understanding the problems presented by ERISA, the following explanation of the relationship of ERISA and the real estate finance market might be helpful.

ERISA was enacted in response to well-documented and well-publicized abuses of their powers by trustees and others in positions to direct the use of pension plan assets. In establishing a nationwide explicit test of fiduciary duty, and clarifying who are fiduciaries subject to the test, ERISA has worked well to encourage widespread responsibility in the pension field. These standards, especially the "prudent man" rule, were an incorporation of a variety of related standards that had been developed and tried over the years in the common law of the several states.

ERISA also introduced a novel approach to protecting pension beneficiaries from self-dealing and favoritism by those in positions to direct the use of plan assets. The "prohibited transactions" section of ERISA, Section 406 (29 U.S.C. 1106), has little legislative history and no widely used and developed antecedents. This section provides:

"PROHIBITED TRANSACTIONS"

"Sec. 406. (a) Except as provided in section 408:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a).

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 407(a)

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

(c) A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a party-in-interest placed on the property within the 10-year period ending on the date of the transfer.

The general fiduciary duty approach of the Act rests on the assumption that pension managers can and should perform their trust by exercising their sound judgment in the best interests of the pension plan. In contrast, the prohibited transaction approach rests on the assumption that pension managers cannot and should not perform their trust by exercising their sound judgment in the best interests of the pension fund. It specifically prevents that exercise in a broad range of circumstances. The transactions prohibited by Section 406 are categorical and are not permitted by the Act, even if they would otherwise be in the best interests of the pension fund, or are routinely performed by other asset managers.

It is this observation that is so frustrating for those involved in home finance. The mortgage market is well established and active. It is a market that allows an investor or a pension plan trustee to measure the prudence of an investment against the investment decisions of other experienced investors. Yet ERISA effectively interferes with pension

fund involvement in both the financing of new construction and in the financing of the purchase of existing, or older, buildings.

MORTGAGE MARKETS

Financing for real estate building projects generally occurs in two phases: short-term loans to the project developer to pay for the cost of construction, and long-term loans to the purchasers of residential units or owners of income property, the proceeds of which are used to pay for the property. The developer pays off the short-term construction loan with the proceeds of the sales of the housing or with the "permanent" financing of the income property project.

Before a lender will make a construction loan, it must be satisfied that long-term financing will be available when the construction is completed. Generally, such a lender, if it does not intend to provide the long-term financing itself, will require a commitment from another lender obligating the second lender to make such long-term financing available. Once a satisfactory commitment has been obtained, the construction loan will be made.

Often a developer seeking a short-term construction loan will contact a company that specializes in obtaining commitments for long-term financing—a mortgage banker. The mortgage banker first makes a determination as to the feasibility of the proposed project. If that determination is favorable, the mortgage banker will agree to attempt to obtain a commitment for long-term financing. The mortgage banker usually looks to financial institutions or institutional investors.

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The investor usually issues a written commitment to provide long-term financing or to buy mortgages from a mortgage banker and, after the building is completed, makes long-term loans to purchasers of the housing units, or takes into portfolio the financing originated by the mortgage banker. Long-term investors include insurance companies, pension funds, commercial and mutual savings banks, savings and loan associations, and the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), the two federally chartered instrumentalities whose purpose is to support an orderly mortgage market. A commitment is made for a specific time period, and a fee is usually charged by the investor.

Under a typical commitment, an investor obligates itself to provide a specific amount of long-term loans to purchasers of dwelling units or owners of income producing property who qualify under the investor's mortgage loan guidelines. In a case where the mortgage banker makes the commitment to provide long-term financing, the investor will obligate itself to purchase a specific amount of mortgages originated by the mortgage banker, provided that those mortgages meet the guidelines. The terms of the loans, such as the amortization period, the rate of interest, the percentage of value loaned, the requirements for loan qualification, the credit worthiness of the borrower, inflation hedges, and the quality of the security, are set by the investor.

Usually, when an investor buys mortgages from the mortgage banker, the investor leaves with the mortgage banker the responsibility for collecting the monthly payments from the owner/borrower, paying real estate taxes and hazard insurance premiums, and otherwise administering the loan. This function is performed for a fee and is called "servicing." Servicing fees are an important source of income for mortgage bankers.

The above explanation describes two markets for long-term mortgages. The market in which the homebuyer or income property owner obtains a mortgage loan, whether directly from an investor or from a mortgage banker, is called the "primary market".

The sale of the mortgage to an investor occurs in what is called the "secondary market." The secondary market also operates in a similar way to finance the purchase of existing, or older, housing or other buildings. No construction loan is involved, of course, and the length of time a commitment to purchase the mortgages is outstanding is generally shorter. In fact, mortgage bankers sometimes agree to originate mortgages on existing housing without having a commitment from an investor, taking a chance that the mortgage can be sold after it is originated.

A variation on this basic way in which mortgage investors acquire mortgages as assets is the rapidly expanding market for securities issued by mortgage bankers and other loan originators based on a collection, or pool, of mortgages originated or otherwise obtained by the issuer. The most popular of these mortgage-backed securities are in the housing finance aspect of the market. These have scheduled payments of principal and interest that are guaranteed by the Government National Mortgage Association (GNMA), a part of the Department of Housing and Urban Development (HUD). The mortgage-backed security device allows an investor to own a small portion of a large number of mortgages and thereby diversify risk and simplify accounting. Mortgage-backed securities are also generally more liquid than whole mortgages, that is, mortgages that are not part of a pool whose ownership is shared by several investors.

ERISA BARRIERS

If a pension fund wanted to be an investor in the mortgage markets as they now function, a violation of one or more of the prohibited transactions provisions of ERISA might arise due to a possible relationship between a pension fund and certain parties involved in the transactions. Fitting the definition of party in interest in Section (3)(14) of ERISA would be: a mortgage banker or other loan originator who is providing loan administration services on loans previously originated or purchased by the plan (a servicing mortgage banker); a developer of a project or a builder involved in the construction of the dwelling units who employs persons covered by a multi-employer plan; and an individual seeking a loan in order to purchase a dwelling unit may be party in interest under, among others, Section (3)(14)(H) of the Act, by reason of being an employee of an employer, a service provider, or a union that is related to the plan.

Therefore, possible violations may arise in several phases of the above-described transactions: the exchange of a loan commitment for a loan fee between a pension fund and a servicing mortgage banker may give rise to a violation of Section 406 (a)(1)(A) and (D) of the Act. A commitment by a pension fund to make loans or purchase mortgages, the proceeds of which will be used to purchase units developed and/or to be built, in whole or in part, by a contributing employer with respect to the fund, might arguably give rise to a violation of Section 406 (a)(1)(B) and (D) of the Act. It should be noted, in this respect, that the Department of Labor has expressed its view that a transaction involving similar possible violations, i.e., the provision of a construction loan by a plan to an unrelated party who contracts with a contributing employer to do the construction, would not, in itself, constitute a prohibited transaction under Section 406 (a) of the Act. If, in the case described in (ii) above, the employer is a fiduciary with respect to the fund, the mere involvement of the employer as a developer or builder might, in itself, be characterized as a technical violation of Section 406(b)(2) of the Act.

The purchase of a mortgage by a fund from a servicing mortgage banker, or a direct loan by a fund, the proceeds of which loan are used to purchase a dwelling unit, which purchase results in the repayment, in whole or in part, of a construction loan to a servicing mortgage banker, might give rise to a violation of Section 406 (a)(1)(A) and (D) of the Act. If the proceeds of a direct loan or a loan purchased by a pension fund are used to purchase a unit developed and/or built, in whole or in part, by a contributing employer, such loan or purchase might be characterized as a violation of Section 406 (a)(1)(D) of the Act. A direct or indirect (through the purchase of a mortgage) loan by a pension fund to a purchaser of a dwelling unit who is an employee of a contributing employer, service provider, or related union might give rise to a violation of Section 406 (a)(1)(B) and (D) of the Act. Although Section 408 (b)(1) of the Act may provide an exemption for such loans from a plan to persons who are participants and beneficiaries with respect to the plan, there is no relief for such loans to employees of service providers or unions that are related to the plan. The provision of additional loan administration services by a servicing mortgage banker might give rise to a violation of Section 406 (a)(1)(C) and (D) of the Act. However, the statutory exemption provided in Section 408 (b)(2) of the Act appears to permit such transactions.

This list is, by no means, intended to be exhaustive. It is illustrative of the uncertainties, the problems, and the dangers pension fund managers face if they try to enter the mortgage market. The effect is to inhibit the entry of pension funds into the area of real estate finance.

EXEMPTION RELIEF

The mechanism ERISA establishes for providing relief from the prohibited transaction rule where it is overly restrictive has not worked efficiently for real estate finance in the past. Under Section 408 of the Act (29 USC 1108), the Secretary of Labor has had authority to grant exemptions for classes of fiduciaries or classes of transactions since 1975. Until May 1982, the Secretary had issued one class exemption with regard to home mortgage-backed securities (Prohibited Transaction Class Exemption 81-7, January 18, 1981) and had proposed for comment a class exemption for mortgages on new houses. (46 Fed. Reg. 58773, Dec. 3, 1981.)

The class exemption regarding certain mortgage-backed securities was welcomed by the housing finance industry. The exemption allowed, under specified conditions, transactions between plans and parties in interest involved in the origination, servicing, and administration of certain types of mortgage pool investment trusts and the acquisition by plans of certain mortgage-backed securities. It did not address all types of mortgage pools and mortgage-backed securities, however, and it took several years and substantial expense to have the Department issue the exemption.

While the Department of Labor was considering its rule, which cleared the basic immediate purchase and sale of securities backed by first lien mortgages, the market was developing more sophisticated variations that offer better investment opportunities. The rule issued May 14 by DOL amending Class Exemption 81-7 responds to the later market developments.

The exemption for mortgages or newly constructed housing had serious flaws, most of which are covered by DOL in the introductory explanation of the new exemption. The

defects were pointed out to DOL and it corrected its proposed ruling accordingly. The significance of the defects, however, was not removed by making the corrections. The defects in the home mortgage proposal, the omissions in the mortgage-backed security exemption, and the time and the expense incurred to produce each of these inadequate rulings demonstrated the failure of the prohibited transaction exemption mechanism now in ERISA, as interpreted by the Department of Labor, to encourage pension plan investment in the highly sophisticated and rapidly developing real estate finance market.

MBA appreciates the opportunity to appear before the Subcommitte and would be happy to furnish any additional information if needed.

STATEMENT OF D. SCOTT McGREGOR, PRESIDENT, THE McNEIL/MEHEW GROUP, SALT LAKE CITY, UTAH

Senator CHAFEE. And let's take Mr. McGregor. And then we will get back to some questions.

Mr. MCGREGOR. Thank you, Mr. Chairman. In deference to my esteemed colleagues here, I agree with what they have said and also, with respect to your comments, I am not going to read my comments. If I have your permission, I would like to speak improvisatorially because I think I would like to get down to a couple of specifics I think you might be interested in.

I feel that you have an extreme interest in this particular bill, as we all do—the entire Nation does. Our company, the McNeil/Mehew Group, of which I am president, was originally organized for the sole and exclusive purpose of channeling pension fund investment into the real estate market. That's all we do. We are very acutely aware of the problem involved in pension fund investing, as well as the problems involved in borrowing.

The impediments of pension fund investment—I would like to get down to specifics and state two things. First of all, on the prudent man rule, in the bill, as it is stated, I don't think it quite goes far enough. We would be more than happy to sit with you or with your staff at a later time and assist in wording. But the general idea is that in the past we have had somewhat of a fixed economy. We are now going into a variable economy. Because of that, we are attempting to take the prudent man rule, adapt it in a fixed economy and trying to make it fit in this variable economy that we have.

What I am suggesting is that we try to make the prudent man rule adapt to our new variable economy. For instance, it says in the prudent man rule that we must limit our investments to current market yield, as the conference committee says. You stated personally you didn't want to see below market rates. I clearly concur with the meaning of what you are saying.

The problem is to say that below market rate or current market yield is to select an arbitrary moment in time, and say that is the current market rate. And, therefore, all long-term investments must from that point forward be based upon that particular rate or higher. What I am suggesting is that what is good for one pension fund may not necessarily be good for another pension fund. What is a good rate of return for one pension fund may be an imprudent rate for another pension fund. So I am saying that we need to broaden that scope and adapt the prudent man rule regarding the rate of return to our variable economy.

The problem there is interpretation of our language.

Senator CHAFEE. Let me ask a question, Mr. McGregor.

Mr. MCGREGOR. Yes, sir.

Senator CHAFEE. Your company is formed for the sole and exclusive purpose of acting as a conduit for pension fund investment in real estate.

Mr. MCGREGOR. Yes, sir.

Senator CHAFEE. Now those pension funds must be under ERISA, aren't they?

Mr. McGREGOR. We've visited from border to border and all across the Nation, both private and public pension funds. So we are dealing both private and public.

Senator CHAFEE. Well, if there are all these restrictions on the investment in pension funds—you say at the bottom of your first page that it is essential that Congress pass legislation to clarify ERISA and permit pension funds to invest in real estate. But that's what your business does now already.

Mr. McGREGOR. Yes. To allow that investment without the impediments. That should have been added to that statement, sir. In other words, as an example, in structuring a pension fund portfolio we want to understand the needs of the pension fund. We then structure the portfolio and get into asset allocation models. You might have something such as stock, bonds, cash, and then we have a percentage of mortgage investments. We get into certain ratings. The manager says, OK, buy these stocks, buy these bonds, buy these cash equivalents. Now mortgages, uh oh. We have to send a letter to ERISA. We have to have a class exemption. We have to have this kind of redtape, we don't need that. Get back into the bonds and the overbalance because nature tends to go on the path of least resistence. We have a specific answer for that particular problem.

So I am saying that the ERISA, as it now stands, on some of the regulations does act as an impediment to pension fund investment in residential real estate. However, I believe that through certain specific changes, some minor, some major, and some additions, we can overcome those particular impediments. And I totally agree with the intent of what you are doing.

Now, any other questions before I go on to the second part?

Senator CHAFEE. No. You go ahead.

Mr. McGREGOR. The second part is regarding the mortgage-backed securities that my colleagues here have already mentioned. Yes, they are being sold in the market. I would recommend very, very strongly that the mortgage-backed securities be given a rating, as they are done now, by a company such as Standard & Poor's. If a pension fund adviser were to be able, under ERISA, to first of all assume a prudent rate, which we said we now have to redefine—if it is a prudent rate and it has a specific rating by an acceptable rating company, he should be allowed immediately under this act to invest in that. Then we have done away with the impediments involved in investing in real estate.

In other words, if we have a mortgage security that is rated, let's say, an A or double A or triple A, for example, and it does meet the adapted prudent man rule regarding rate of return, then he can invest in that. Right now, there is too much redtape and too many impediments to do that.

So I am saying let's look at the merit of the mortgage backed security based upon its security rating. Then, let's look at the individual needs and requirements of the structuring of that portfolio. And let that manager assist in deciding whether or not that is a prudent investment.

Now, also, I am advocating that any of the private offerings not have to be regulated, such as the TIM's. We strongly advocate that.

They shouldn't be regulated by the Government as far as Ginnie Mae, Fannie Mae, or Government sponsored in that respect.

So my two statements to the committee would be, first of all, to adapt the prudent man rule to our variable economy; and second, to be able to allow pension fund managers to accept mortgage-backed securities on a rating basis, merit, of a particular investment.

The rest of my testimony you can read in more detail. We would be more than happy to provide our staff and anything that is necessary to assist you in this which we hardily agree with.

[The prepared statement of D. Scott McGregor follows:]

STATEMENT OF D. SCOTT MCGREGOR,
PRESIDENT OF THE McNEIL/MEHEW GROUP, INC.,
BEFORE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT
POLICY OF THE SENATE COMMITTEE ON FINANCE ON
S. 2918 THE RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1982

MONDAY, SEPTEMBER 27, 1982

The McNeil/Mehew Group, Inc. of Salt Lake City and New York was formed in February, 1982 for the sole and exclusive purpose of acting as a conduit for pension fund investment in real estate. The group has therefore had extensive experience in this unique specialty which this proposed legislation specifically addresses.

It is an essential element of our business to know and understand the needs and objectives of pension funds throughout the United States. In addition, we must also be aware of the borrowing public's needs and objectives. Unfortunately, our national policy rarely addresses both the investors' and the borrowers' viewpoints as it should. We believe such an approach can create a true equilibrium, a "win-win" situation in which neither the borrower nor the lender would be at the mercy of the market but both could achieve equitable and predetermined values.

We are heartened that the Congress is beginning to take action in this important area. We believe that this proposed legislation is sound and can contribute to the rebuilding of one of our nation's largest industries, the residential construction business.

In our view, it is essential that the Congress pass legislation to clarify ERISA and permit pension funds to invest in real estate.

At present, as the Committee knows, such investments are not permissible. The regulatory procedure is difficult, lengthy, cumbersome and expensive.

The need for investment is critical and does not relate exclusively to the health of the construction industry. It also concerns the potential for millions of ordinary Americans to make sound long-term investments in home ownership.

In the context of the proposed legislation, we would like to make several suggestions about ways in which we believe the legislation could be improved.

First, we suggest that the Committee consider a change from the word "practices" as used in Section 2 of the bill. This term appears to allow only residential mortgage investments that are already regular practices or transactions and suggest that it may be difficult in the future, under the terms of the bill as drafted, to implement changes or innovations in the mortgage market. Therefore, we suggest that the term "customary procedures" or words to that effect be used in the Act to indicate that the legislation concerns the method of implementation of mortgage instruments. Procedures in the mortgage industry tend to be long established and tend to change very little compared with practices or transactions.

In addition, we have a general concern with the so-called "Prudent Man Rule". As the Committee knows this rule has been subject to different interpretation in different contexts. Needless to say, some form of guideline must be used to restrain irresponsible managers who have fiduciary responsibility from making unreasonable or

self-aggrandizing investments which would have a negative effect on the pension fund. And yet our present concept of "prevailing rate" is also inadequate since we have seen drastic changes in the "prevailing rate" from week to week and year to year over the last decade. We therefore suggest that what is "prudent" cannot be established by some blanket statement but that the legislation must provide some wider latitude to the pension fund manager to permit to seek the rate of return that is consonant with the integrity of the pension fund, the objectives of the pension fund, and the realities of the market place and measured over the life of the investment as opposed to some arbitrary moment in time.

We congratulate the administration on backing such concepts such as the TIM (trust for investment in mortgages) and other such ideas. However, we do feel very strongly that they should not be regulated by FNMA or other government or quasi-governmental agencies. We believe that the private sector can provide pools to fill the needs in the market place as easily as can the government. Therefore, we need to ease the entrance ability of pension funds into the mortgage pass-through or mortgage-backed securities field by allowing a decision for their purchase to be made on similar grounds that would be used in purchasing stocks, bonds, cash equivalents, etc. Such decisions are based on over-all portfolio structuring. Once the needs of a portfolio are established, the pension fund manager

builds an asset allocation model based upon those objectives and begins his diversification process. Once the diversification asset allocation model has been established, and a percentage of the portfolio is allocated for mortgages, an investment advisor could at that point select mortgages from mortgage-backed securities around the nation that have specific ratings. They then could be selected on their merits, as opposed to having to go through several ERISA exemptions and other red tape. We recommend a minimum of a Standard & Poors "A" rating.

Therefore, we strongly suggest that mortgage-backed securities can now be evaluated on Modern Portfolio Theory against stocks, bonds and cash equivalents of equal rating.

We are pleased to offer this statement and these suggestions to the Committee and would be glad to provide the Committee or its staff with such further information or research as it may require in developing this legislation.

Senator CHAFEE. OK. Let me ask the panel some questions here. Would you permit a pension fund to make a direct mortgage-backed loan? In other words, lend somebody some money to buy a house. In other words, have the pension fund own the mortgage.

Mr. JOHNSON. Would I, sir?

Senator CHAFEE. Yes.

Mr. JOHNSON. I would have no reason to prohibit a pension fund from making a mortgage, that I could think of. Mortgages are not overly difficult to prudently underwrite. I have trouble believing that they would want to, when their local bank or S&L or mortgage company might want to do that for them as a service—applying normal underwriting standards and place it with them. In that way, the pension fund wouldn't have to add any staff.

Senator CHAFEE. It seems to me one worry here is that we have had testimony that some of the pension funds might want to help out their members. That is, the participants in the pension plan. Help them to get mortgages. And it seems to me that is a dangerous business. We don't want to encourage that. Because not only of the difficulties of not only administering it, but the question of whether it truly is a good investment. What do you say to that, Mr. Smith?

Mr. SMITH. Mr. Chairman, I believe you have in place a perfect delivery system today through the mortgage banking industry, commercial bank, thrift and others to properly and adequately furnish the underwriting teams. And I really believe that that would give you a good system. They are in place.

As he mentioned, you would have the additional expense for the pension fund. Remember, we are talking about residential mortgage, now, not large commercial mortgage.

Senator CHAFEE. Yes.

Mr. SMITH. And the servicing of these residential mortgages, it would just seem to me, would be better served through the existence of the present delivery system that is available.

Mr. JOHNSON. Senator, if I might just make one more comment. It seems to me that one of the things that is mentioned often is the fantastic performance that mortgages really have had as an investment. They have given good returns, and they have been very safe investments.

One of the reasons they have been very safe investments is because they have been professionally underwritten. I'm not saying that a pension fund couldn't add a staff of professional underwriters, but it is the skill that is not acquired over night.

Mr. MCGREGOR. Mr. Chairman.

Senator CHAFEE. Yes.

Mr. MCGREGOR. May I respond to that and just underscore the idea that in Utah, for example, the State of Utah, with our assistance, did $50 million in the local market last year. They did it at a rate people could afford. They did it on a program that was developed that would give prudent returns to the funds. But at the same time—it was a double A rated security—it was a rate that borrowers could afford. And at the same time, it was given out on a nondiscriminatory basis. And the members of that fund could obtain those mortgages.

So the point there is that it was not given out discriminatorily to them first; it was given out nondiscriminatorily. And I think on that basis I don't see any problem in giving it out if it is administered by a pool, if it is insured and it does have a decent rating and it is given out nondiscriminatorily.

Senator CHAFEE. But where I get confused is that I understand the current rules under ERISA that the Labor Department has set forth is that pensions cannot invest in any mortgages except those that have been packaged by Fannie Mae or Ginnie Mae or the Farmers Home Loan Bank Board. Is that true?

Mr. SMITH. Freddy Mac. Yes, sir.

Senator CHAFEE. Freddy Mac, yes.

So I don't understand how you are able to—how were you able to do what you did in Utah?

Mr. MCGREGOR. Utah was done by a public pension fund.

Senator CHAFEE. So that's not subject to these rules?

Mr. MCGREGOR. That's right. That's right.

Senator CHAFEE. I get it.

Mr. MCGREGOR. And that's the problem we are faced with in the private industry. Unless it is backed by Freddy Mac, Ginnie Mae, Fannie Mae then it can't be done.

Senator CHAFEE. Now what would you envision happening under this? Would you envision that the way we get more money available for homebuilders is that some private firms would get together a pool of mortgages and peddle those? Isn't that it? Instead of having it go through Fannie Mae or Freddy Mac or whoever it is, that's the way it would be. Some investment bankers would get together a big pool of mortgages and sell them to the pension funds. That's really what we are striving for, isn't it?

Mr. JOHNSON. We would hope so because that's what we do for a living.

Mr. SMITH. Well, of course, the livelihood of a lot of people in the business today—with 1 million laid off—is determined by such aspects today, as well as the home buyers. But I might add, Mr. Chairman, that you brought up a very good point.

For example, in the private pension fund area that we are talking about today, it would be illegal to go to a mortgage company and try to put mortgage loans together which have 50 percent down on very good conventional loans, and do not fall under the allowable categories of FNMA, GNMA, or FHLMC. That doesn't make sense.

In addition, investment in the multifamily area is restricted here. It is also necessary to look at some multifamily residential mortgages, for the young couples coming on stream that are needing that first apartment.

We find this condition to be very restrictive in the private pension fund area. And we think that your bill will relieve mortgages of these impediments and put them on the same level, then, as bonds and stocks.

Senator CHAFEE. Looking at it from a pension fund viewpoint, do they have any problems with the liquidity of the investment?

Mr. MCGREGOR. Maybe I can address that. In our meetings with numerous pension funds, a large question is liquidity. However, many, many private pension funds, if they could be assured that it

fit within their asset allocation models in their portfolio planning, would buy an illiquid investment within a pool. In other words, if we had a double A rated pool, a triple A rated pool, they would take a certain amount of those funds to fit their asset allocation model. However, liquidity is the desirable element; it is not absolutely necessary.

Let me categorize this a little further. It is more necessary in the private sector than it is in the public sector. But in reality, if you had a yield instrument that was——

Senator CHAFEE. You have got to go slowly on that for me. It's more necessary in the private sector——

Mr. MCGREGOR. The private pension funds, meaning private corporation pension fund, versus public pension funds.

Senator CHAFEE. Why so?

Mr. MCGREGOR. Why so is the societal pressure that the public pension funds feel much more so than the private pension funds. Now to get into residential——

Senator CHAFEE. I still haven't got that. The societal pressures—explain it further.

Mr. MCGREGOR. What we feel is tremendous social pressure to get into residential real estate financing—that's why you and I are here today—that's what we call societal pressure, the ones that are yielding to that societal pressure.

Senator CHAFEE. You mean on the part of the public pension funds?

Mr. MCGREGOR. Yes.

Senator CHAFEE. Do they feel they have got to put their money into the hometown somehow?

Mr. MCGREGOR. Yes.

Senator CHAFEE. Helping the hometown and stimulate the hometown's mortgage activity.

Mr. MCGREGOR. That's right. And a private pension fund does not necessarily feel that particular societal pressure as much. And, therefore, wants to go strictly on the merits of the particular investment.

Now on that basis, ERISA offers an impediment because we could offer the same type of securities as a stock or a bond and the private pension funds could get into that particular area, but won't because of the illiquidity of it. On the other hand, if it is a publicly traded one, we answer the problem of liquidity. If it's a variable yield instrument, which there are several of on the market and some of which are excellent and some of which are lousy—if we get into the variable yield instruments, then we answer the problems of rate of return to the fund. So we are talking about an instrument, and we are talking about liquidity. And then we can entice the private funds as well as the public funds.

Senator CHAFEE. What do you say to that, Mr. Johnson?

Mr. JOHNSON. Well, I was going to answer, but I got listening to my colleague here on my right, and I forgot what I was going to say.

Senator CHAFEE. What do you say to what he is saying?

Mr. JOHNSON. About the pension funds?

Senator CHAFEE. Yes.

Mr. JOHNSON. Their willingness to buy what would be known as an illiquid investment. There are two things. The pension funds as an industry make what they call private placements daily which are, by their definition, illiquid. They are the debt of corporations or privately placed stock of corporations. I think pension funds are capable of dealing with illiquidity, and they do so because they have got money that they can put away. And the way they deal with illiquidity is they compete for it on a yield basis. They get more yield for a give up in liquidity.

I think in our mortgage markets we will have two distinct classes of investments for pension funds. One which would be the liquid, Government-backed securities—Fannie Maes or Freddy Macs or Ginnie Maes. And then private placements, which would be less liquid. Private placements would probably command a higher yield, or have other desirable characteristics that Fannie Mae and Freddy Mac are prohibited from having.

Senator CHAFEE. What about the cash flow? Does that give them a worry?

Mr. JOHNSON. That's one of the more desirable aspects of it.

Senator CHAFEE. Don't you think it is an even cash flow, the way they have got it worked out?

Mr. JOHNSON. No, it's not.

Senator CHAFEE. I wouldn't think so.

Mr. JOHNSON. But the cash flow in a mortgage pool is a two-edged sword. It tends to be a good deal if rates are rising, in general, because it tends to give that investment a higher total return than one of a bond where the cash flow does not increase at all. If rates drop, the cash flow might increase at that point, too. And then your total return would be less. There are ways to hedge against that sort of thing. So again, that is simply a tradeoff that the pension fund manager will generally take care of in his requirements for yield.

Senator CHAFEE. Well, I'm not sure I followed all that. It seems to me if interest rates are rising, the cash flow would remain more consistent, wouldn't it, because fewer people would be selling their houses?

Mr. JOHNSON. Well, that wasn't necessarily true until rates got so high as to shut everything down. Mortgages outperformed every other kind of investment in the middle part of the 1970's or the early part of the 1980's because there was a lot of activity even though rates were rising. And that cash flow was being reinvested at a higher and higher yield.

Mr. MCGREGOR. Until you get to such a high yield that someone can't borrow.

Mr. JOHNSON. Yes.

Mr. MCGREGOR. And then you have investment moneys there for mortgages and no one to borrow it. We have to develop new vehicles that will give the yield and yet allow someone to borrow.

Senator CHAFEE. Mr. Smith.

Mr. SMITH. Mr. Chairman, the deregulation act, of course, has allowed the funds and the pools to look at different instruments. And at least the fund manager today can look at fixed rates or very flexible rates to meet their particular requirements. And I believe that this gives them the stability and the prudent look down the

road if they so desire to get into the change in rates, depending on the economic conditions.

Senator CHAFEE. Let me ask you this question again. I'm not sure I understood the answer. My question is: Are there worries from the pension fund viewpoint of pressure from what you might call societal investment in this? And by "societal," I mean toward members' breaks for those pensioners who belong to the fund.

Mr. SMITH. Well, Mr. Chairman, as he mentioned earlier, of course, in the public pension funds this is more so. But let's take the private pension funds that may have a corporate office across country from where their local office is located.

The impediments of today's private pension funds makes it easier to say no to a pool or to a program being set up. I really believe that if these impediments were changed, if they were eliminated, you would see an educational process throughout the country that would move this fund forward. The fact they only have 1 percent of their assets in residential mortgages tells us there is either a real impediment or a concern in this area. And we believe this particular legislation will release the impediment and then we can remind them of the concern.

Mr. MCGREGOR. Mr. Chairman.

Senator CHAFEE. Yes.

Mr. MCGREGOR. Is your question, sir, "does the giving of mortgages to the contributors of a pension fund pose a problem"?

Senator CHAFEE. That worries me.

Mr. MCGREGOR. It does me, too.

Senator CHAFEE. What we are doing here is opening the doors, possibly, to an abuse in which X union pension fund—it's decided by the trustees of the pension fund that they will make a special effort to make these funds available or to take mortgages involving their people. Now that's perfectly commendable and a logical thing. They want to buy homes, build homes, and what better place to go to than their own pension fund? And you have got the potential area for abuse, I believe. And I would like to be reassured.

Mr. MCGREGOR. May I address that?

Senator CHAFEE. OK. Let's take Mr. McGregor.

Mr. MCGREGOR. I respect that completely, and we have discussed this with pension funds.

Senator CHAFEE. And further with that, aren't you opening it up for the same societal pressures that you said exist in the public pension funds?

Mr. MCGREGOR. I have to agree with you in that case. Also there is a modern portfolio theory problem, an academic problem, addressing that. And that is if I were a pension fund manager and I opened up my pension fund mortgages only to my people, I then negate the advantage of diversification of my portfolio.

Senator CHAFEE. No. You don't open them up only to your people, but you give a tilt toward your people.

Mr. MCGREGOR. Or if I tilt even, I therefore tilt my diversification, and my asset allocation model is not valid. So, therefore, what I am saying is you are correct. So my recommendation, very hardily, would be that any transaction such as this would be handled by a competent arm's length transaction agency such as the MBA members. They have already said it—a private pool has been set

up by, say, Maggie Mae of MGIC. If we could set up something such as that handled by competent mortgage banking people, I think we would overcome that problem.

Mr. JOHNSON. My only comment would be that—I have talked with a lot of pension fund managers and one gentleman explained to me his problem with pressures from members of the unions, the funds for which he was investing. He was a municipal fund manager so he had more than just unions he was talking about. I don't want to pick on unions.

Senator CHAFEE. Speak clearly, Mr. Johnson. Sometimes you go so fast I have trouble taking it all in.

Mr. JOHNSON. I'm sorry, sir. I have spoken with many pension fund managers. I had the opportunity to speak with one gentleman that explained to me that if he invested his pension funds either with his people who he was investing the funds for or in the communities where these people were employed, the diversification problems could become major if there was a down turn in that local area. Not only would these people have problems with their local economy, but they would also, at the same time, be causing problems with their pension funds because they had invested more and more of their pension funds right in the local economy, almost to its detriment.

He, therefore, said—he was involved in public funds and ERISA was not a consideration—he just wouldn't do it because it wasn't prudent. And the point I am trying to make is I don't think the sort of thing you are concerned about will happen to any large extent because of the fact that under the way you have drafted this legislation the prudent man rule is alive and well. And I have a hard time believing that the prudent investor of pension money can truly abuse this process, if he considers the prudent man rule in his thinking.

Senator CHAFEE. It's all well and good to apply the prudent man rule and come and sue some trustee, but the damage may have been done. And, obviously, that's why the tight restraints are written into this so that you don't have the temptation there for trustees to go into areas that might potentially have the cause for damage.

OK, gentlemen. Is there anything else you want to ask?

Mr. SMITH. I might just add in my conclusion that a single-family mortgage as the way of insuring across the table, unlike a very large commercial mortgage that would jump out were one loaned, could be hidden under a basket because this would be recorded and be knowledgeable throughout the community. And you would insure yourself through the spread, Mr. Chairman.

Senator CHAFEE. Do you see chances for lower interest rates if we enacted this legislation?

Mr. SMITH. Yes, sir. As I mentioned earlier in the chart I showed you, the barrel has little water left in it. And at least remember that if mortgage investment were to increase to only 10 percent of the private pension funds, you would have $30 billion available for that market. Yes, sir, it definitely would.

Senator CHAFEE. OK. Well, we will be talking with the Labor Department. I think there is some hope that we can resolve our differences.

Thank you very much for coming, gentlemen.

I am going to put in a statement from Mr. Gephardt and from Mr. Wyden on this matter.

[The prepared statements of Congressmen Richard A. Gephart and Ron Wyden follow:]

STATEMENT BY REPRESENTATIVE RICHARD A. GEPHARDT

Before the

Senate Finance Subcommittee on Savings, Pensions, and Investment Policy

September 27, 1982

I would like to thank the Subcommittee for allowing me to testify today in support of S. 2918, the Residential Mortgage Investment Act of 1982. As many of the members of this Subcommittee already know, I am one of the three original sponsors of the House companion measure, H.R. 6781. This measure has received widespread, bipartisan support with more than 265 members as co-sponsors.

By removing the impediments to pension fund investment in the residential mortgage market, this legislation is designed to address two very important problems: the need to ensure present and future employee benefit plan beneficiaries that their plan assets are safe; and the need to aid the housing industry through capital infusion into the residential mortgage market.

I need not tell the members of this Subcommittee that the housing industry is in the worst state that it has been in over 40 years. If the current projections hold true, 1982 will prove even worse than 1981 when new housing production was the lowest since 1946. Only 1.1 million units were produced. While new home sales were [illegible] lowest level ever recorded, existing home sales suffered as well with a 50 [illegible] decline from 1978.

[illegible] shortage of mortgage capital, while a direct result of our current economic difficulties will probably continue as our economy gets better. Because the [illegible] and loan associations throughout the country have been moving out of the mortgage origination business, and will probably continue to do so, alternative sources of mortgage capital must be found. Employee benefit plan funds represent the largest source of long-term capital; public and private pension plans together now have more than $700 billion in assets. This figure is expected to top the

$1 trillion mark by 1990.

Let me assure all of the members of this Subcommittee, before turning to the finer points of this legislation, that this legislation will in no way jeopardize the present or future benefits to plan participants; it could only have a positive effect. A recent survey conducted by Salomon Brothers which examined the returns of alternative investment opportunities, including mortgage securities, highlighted the attractiveness of mortgages as an investment medium. The survey concluded: "Results show that the mortgages outperformed the three alternative investments: Corporate bonds by 15.3 percent; long Treasuries by 21.7 p[illegible]nt; and 10-year Treasuries by 2.4 percent." With the higher return that a pension fund might be able to receive on investment in mortgages it might be able to reduce contributions required of plan participants or increase the benefits to present and future beneficiaries.

If residential mortgages are to be considered by pension plans as equal to or better than investments currently made, pension plans, the mortgage market and those involved in its operation must be allowed to operate without undue restriction. This legislation expands on the Department of Labor's recent regulations (Federal Register, Tuesday, May 18, 1982. p. 21325) allowing private pension funds to invest in securities offered by the Federal National Mortgage [illegible], the Federal Home Loan Mortgage Corporation, or the Government [illegible]age Association. While these regulations represent an improvement, [illegible]ot go [illegible]r enough in allowing pension funds additional investment opportunities [illegible]he residential mortgage market. The problem is that rules governing private pension funds discourage--though do not prohibit--investments in mortgage securities.

Unless an employee benefit plan invests solely in the securities issued by the Federal National Mortgage Association, Federal Home Loan Mortgage Association

or Government National Mortgage Association (mortgage-backed securities) a plan must meet the conditions set forth in the Department of Labor class exemptions for residential mortgage transaction (82-87) or mortgage pool investment trust transactions (81-87).

The conditions that must be followed relate to the type of dwelling unit and mortgage loan covered, and the business entities and persons qualified to be involved. Plans may invest in "recognized mortgage loans" on residential dwelling units, defined generally as owner-occupied, non-farm property of one to four units, (including townhouses, condominiums, manufactured housing, co-ops and investor-owned units) which at origination were eligible for purchase through an established program by Fannie Mae, Freddie Mac or Ginnie Mae. The decision, however, regarding the mortgage loan commitments, purchases or sale must be made on behalf of the plan by an independent fiduciary (defined as a "qualified real estate manager"). The loans must be originated directly for the plan or by the origination-purchase process by an "established mortgage lender". This entity must be a HUD approved lender, Fannie Mae/Freddie Mac approved seller/ servicer, State housing finance agency or independent State authority.

If a plan is investing in mortgage-backed securities other than those ued by Fannie Mae, Freddie Mac or Ginnie Mae, the plan must hire an independent prove the purchase of the certificate and pay no more than fair ...lue for the certificates. In addition, the value of the certificates ...d by the plan must not exceed 25% of the amount of the issue, and 50% ...e issue must be acquired by persons independent of the pool sponsor, trustee or insurer.

Both sets of conditions are restrictive in that they impose higher standards for mortgage investments than for other types of investments. In addition, if a

plan does not follow the conditions or is uncertain if a particular mortgage transaction is covered by the exemptions, the plan must request an opinion or seek an individual exemption from the Department of Labor. This procedure in itself is costly and burdensome and it is unlikely that a Labor Department response could be expected in less than 90 days.

With those impediments and the fact that many pension funds require only a 6.5% to 7% return on their assets to meet the needs of present beneficiaries, many fund managers would rather not bother at all with mortgages even though they may be able to receive a return on a recent issue of Fannie Mae securities of over 14%. These impediments must be eliminated so that pension fund capital can flow into the residential mortgage market benefiting both pension fund participants and the housing industry. With the long-term liabilities of pension funds, they are particularly suited to lending long-term.

While the Department of Labor's regulations opened up approximately 46% of the secondary mortgage market to pension fund investment, there are still vast opportunities out there for investment. The entire Missouri Congressional delegation recently endorsed a state-wide program to highlight the attributes of the growing equity mortgage for pension fund investment. This program, however, [illegible] not have been allowed under the May 18 Department of Labor regulations [illegible]ic exemption. Responding to market pressures, both Fannie Mae [illegible] decided to package these new growing equity mortgage securities. [illegible]r help we might still be waiting to start our program.

This legislation should in no way be misconstrued as violating the employee benefit plan's statutory duty of protecting the interests of its beneficiaries. It does not require investment in residential mortgages. It is simply attempting to put them on a par with other investment opportunities.

I thank the members of the Subcommittee in allowing me to testify today and urge their approval of this legislation.

STATEMENT
CONGRESSMAN RON WYDEN

ON

S 2918

THE RESIDENTIAL MORTGAGE INVESTMENT ACT

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
COMMITTEE ON FINANCE
UNITED STATE SENATE

SEPTEMBER 27, 1982

Mr. Chairman, I would first like to express my sincere appreciation for your efforts on behalf of this vital piece of legislation and for allowing me the opportunity to participate in this hearing.

As I'm sure the Committee is aware, Congressmen Dick Gephardt, Barber Conable and I introduced a bill very similar to S 2918 in the House on July 15 of this year. Since that time, our bill (HR 6781) has attracted more than 260 cosponsors in the House and we are now actively pursuing ways to get this bill ti the floor of the House for a vote before the 97th Congress adjourns.

Working closely with the National Association of Homebuilders, I have been actively involved with this issue for more than a year. Last winter, I wrote to Labor Secretary Donovan to alert him to my interest in an application for a class exemption from the prohibited transactions section of the ERISA statute that was then pending before the Labor Department and to express my view that the broadest possible exemption possible was vitally necessary if mortgage securities were going to be allowed to compete on an equal footing with other forms of investment for the attention of private pension fund managers.

My interest and involvement in this area is the direct result of the tremendously important role played by the timber, lumber, housing and real estate industries in the economic vitality of my home state of Oregon.

Because of the longest and most severe slump in housing in more than 40 years, Oregon is experiencing its longest and most severe economic slump in more than 40 years. In many Oregon communities, the effects of the recession have been devastating, with unemployment rates running close to the worst levels experienced in the Great Depression of the 1930s.

The diagnosis of the housing industry's malaise is clear: a severe shortage of affordable mortgage capital that has driven mortgage interest rates up to unprecedented levels and priced all but a miniscule percentage of the American people out of the homebuying market.

The cure is also clear: find new sources of mortgage capital. And pension funds, both public and private, represent the largest potential new source of mortgage capital -- more than $600 billion.

At the present time, only about 3 per cent of this vast pool of funds is invested in housing and real estate. There is no reason why that percentage should not and can not be higher -- without endangering the prudent investment of pension funds..

Mortgages and mortgage-backed securities are sound, safe and profitable investments. A recent Salomon Brothers survey showed that, over a 10 year period, mortgage securities outperformed investments such as corporate bonds and long-term U.S. Treasury notes.

Many states across the country are now pursuing innovative and exciting programs designed to encourage public pension fund investment in housing and mortgage securities. In the state of California, more than $100 million has been invested in mortgage instruments so far and the results are impressive: 6,746 jobs created, $144 million in personal income and $20 million in tax revenue generated. Both candidates for governor of California this year have endorsed this program and are calling for an expansion of this type of investment.

There is no reason why a similar surge of investment by private pension funds in housing should not occur and should not have similarly impressive results in stimulating new housing construction, creating new jobs and generating new revenue.

One reason why there has not been greater private pension fund investment in housing is because the United States Department of Labor, in interpreting the Employment and Retirement Income Security Act, has seen fit to promulgate restrictive regulations that apply only to pension fund investment in housing and, in my view, have discouraged pension fund managers from considering mortgage investments.

The class exemptions issued by the Department of Labor in May still do not reflect the realities of the mortgage marketplace and ERISA regulations continue to restrict unnecessarily mortgage investment and continue to treat housing as a second class investment.

Mr. Chairman, HR 6781 and S 2918 are a direct result of a view you and I share with many other members of Congress that the action taken by the Labor Department this spring was not sufficient. Both bills would remove the additional arbitrary regulatory impediments and permit mortgages to compete for the attention of private pension fund managers on an equal footing with other types on investment.

Let me take this opportunity to list what I consider to be some of the major specific shortcomings in the Department of Labor's position on this issue:

- The exemptions limit pension fund investments to "recognized mortgage loans," but define that to mean only loans that qualify under Fannie Mae, Ginny Mae or Freddie Mac -- roughly 60 per cent of the residential mortgage market. There is no reason why other conventional mortgage securities packaged by private mortgage investment bankers should be excluded. Salomon Brothers alone has handled $71 billion in conventional mortgage securities in just the past 16 months.

- The Department chose not to extend the exemptions to multi-family housing, even though requested to do so.

o Plans are still forbidden to participate directly in the mortgage investment marketplace. Investments must be made through an "established mortgage lender", approved by HUD or some other government housing finance agency.

o Pension fund managers are arbitrarily prohibited from purchasing more than a specified and limited percentage of any particular issue of mortgage backed security certificates.

o If a employee benefit plan does not follow the conditions included in the Department's "class exemption" -- or if a fund manager is uncertain whether a particular mortgage transaction qualifies under the exemption -- the plan must request an opinion or seek an individual exemption from the Labor Department.

o This procedure in itself is costly and burdensome. It is unlikely that a Labor Department response could be expected in less than 90 days. In this interim period, many profitable investment opportunities could be lost.

o Most important, pension fund managers are still not allowed to make mortgage security investment decisions on their own. The manager instead must delegate this decision to an independent fiduciary or "qualified real estate manager." This requirement -- which applies exclusively to mortgage investments -- creates a psychological barrier, adds additional costs and erodes whatever competitive edge the investment might have on its own merits.

Once again Mr. Chairman, Congressman Gephardt, Congressman Conable and I introduced HR 6781 because we share your view that this list of special restrictions on pension fund investment in housing includes real and substantial barriers and is not supported by sound economic reasoning.

Under the ERISA statute, pension plan trustees are given the responsibility and authority to direct and control the investment of penion plan assets. We believe the Department of Labor, in restricting mortgage investment capabilities, has usurped this responsibility and authority to an unreasonable degree, a degree that is not only economically unsound, but also fails to reflect the intent of Congress.

We introduced this bill because we believe that, by removing these arbitrary regulatory impediments -- while retaining the basic prudency, diversity and arms length transaction standards -- pension funds will have a new incentive to invest in housing.

We believe that a significant new infusion of mortgage capital will quickly flow from private pension funds to the housing marketplace and that this new source of capital is bound to have a downward impact on mortgage interest rates.

California's Public Investment Strategy program has already plowed the ground and has proven how a prudent investment of a reasonable percentage of public pension fund reserves can serve as a real stimulus to a state's housing and construction industries.

There is no reason why a similar surge in housing construction cannot happen all over the country if mortgage securities are allowed to compete on a level playing field with other private pension fund investment opportunities.

Although the objectives of HR 6781 and S 2916 are the same, there are differences between the two bills as originally introduced. After further consideration, my colleagues in the House and I have concluded that, as a matter of policy, the language of your bill is preferable and I want you to know that an amendment in the nature of a substitute to HR 6781 was printed in the Congressional Record last Thursday. This amendment is identical to S 2916 and it is this version of HR 6781 that we are actively seeking to place on the calendar for a vote on the floor of the House.

Mr. Chairman, once again, I thank you for the opportunity to participate in this hearing. I hope I have helped convince the other members of the committee that a legislative revision of the ERISA regulations on mortgage investment is a reasonable and sound method of encouraging new pension fund investment in residential housing.

Senator CHAFEE. Thank you.

[Whereupon, at 4:15 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT

OF THE

AMERICAN BANKERS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

SENATE FINANCE COMMITTEE

ON

THE RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1982

S. 2918

September 27, 1982

The American Bankers Association (ABA) is pleased to have the opportunity to share its views on S. 2918, which is designed to encourage mortgage investment by pension funds. ABA is a national trade association whose members consist of more than 13,000 banks, more than 90 percent of the full service banks in the United States. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another. At the end of 1980 banks managed more than $225 billion in over 300 thousand employee benefit accounts. Nearly $12 billion is held in real estate mortgages and pass-through certificates.

ABA has testified on numerous occasions before this and other Congressional committees on the difficulties ERISA's prohibited transactions cause plan fiduciaries and investment managers. These provisions are the overriding problem banks have with ERISA in investing for employee benefit plans. In our view it is these prohibitions, contained in Section 406 of ERISA, which serve as a major deterrent to investment of employee benefit plans in assets other than stocks, bonds and other publicly traded securities through brokers.

The provisions enumerate a broad list of transactions into which a fiduciary may not cause a plan to enter. Subsection (a) of Section 406 lists the activities into which a fiduciary may not cause a plan to enter with a

"party in interest", while Subsection (b) prohibits transactions which are essentially self-dealing in nature. A "party in interest" is defined in Section 3(14) of ERISA to include an almost limitless class: an employer, or 50 percent owner of an employer, whose employees are covered by the plan; any counsel or fiduciary of the plan, or a relative of any of these. The term also includes employee organizations whose members are covered by the plan and any employee, officer, director, 10 percent shareholder or partner or joint venturer of an employer, service provider to the plan or employee organization.

The types of transactions prohibited include sales or exchanges of property, lending of money, furnishing goods or services and the transfer to or use by a party in interest of any of the plan's assets.

When one considers that many large plans have several banks, investment advisors and insurance companies, all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions becomes virtually impossible in the ordinary course of business.

The number and variety of possible transactions that are prohibited are enormous and the vast majority would be innocently entered into in the plan participants' best interests. It is unreasonably burdensome for even the most diligent trustee to keep track of or even know the ever changing list of parties in interest and to review all these

relationships with respect to each and every plan transaction.

The prohibited transactions provisions do not apply to security purchases or sales where there is a blind purchase through a broker. But mortgages, mortgage-related investments and other direct or private placements have become a nightmare of complexity because of Section 406(a), the breadth of parties in interest and the number and variety of service providers who may be involved in these transactions.

ERISA has granted the Labor Department broad exemption authority from the prohibited transactions provisions. However, to date, our experiences with the exemptive procedures of the Department of Labor have been most unsatisfactory. Exemptions take far too long and, even when finally granted, are too often limited by such exceptions and qualifications as to be of little practical relief. The mortgage exemptions issued earlier this year, then, are typical. As a result ABA has repeatedly urged repeal of the prohibited transactions provisions, at least that portion relating to transactions with parties in interest. We believe the standards of undivided loyalty, exclusive purpose and prudence contained in other provisions of ERISA make Section 406(a) redundant and unnecessarily burdensome.

ABA applauds the direction of S. 2918. It exempts from the party in interest prohibitions mortgage transactions which conform to the normal business practices of the

mortgage industry, those which are commercially reasonable. It does not dilute the rule of prudence, nor does it alter the exclusive benefit rule. If it is desirable to remove the application of these restrictions from mortgages then we submit it is equally, if not more desirable to remove the applicabilty of the prohibited transaction provisions from all investments. ABA urges the Committee to give serious thought to expanding the scope of this legislation to include all investments so long as they are both prudent and, in the words of ERISA, entered into for the "exclusive purpose of ... providing benefits to participants and their beneficiaries."

In our Association's testimony before this subcommittee in May of this year we discussed some of the characteristics of mortgage investments which made them less attractive than other investments. At that time we suggested the need for a new instrument which would eliminate those difficulties and make mortgage investments more attractive. We are pleased to note two developments which evidence movement in that direction. The Administration is far along in the progress of its TIM program. TIM, or the Trust for Investment in Mortgages, is an outgrowth of the President's Housing Commission. The program is specifically designed to encourage the participation of the private sector in housing by permitting greater flexibility in packaging mortgage backed securities. The recent development is the introduction by Federal National Mortgage Association(FNMA)

and Federal Home Loan Mortgage Corporation (FHLMC) of their Growing Equity Mortgage (GEM) program.

While we support the removal of impediments which stand in the way of investment flexibility, ABA is gravely concerned about proposals for mandating or allocating pension investments for social purposes. We firmly believe that the fundamental standards contained in ERISA are sound. A fiduciary must carry out his responsibilities as would the "prudent man", under similar circumstances, "solely in the interests of the participants and beneficiaries". Further, the fiduciary must be ever mindful that the "exclusive purpose" of employee benefit plans, in the words of ERISA, is to provide "benefits to participants and their beneficiaries". The trustee, in choosing particular investments, must take into account all the present facts and circumstances and the prospects for the future. Additionally, ERISA requires that the investments be diversified so that the risk of loss is minimized. Thus, in picking the investments which make up a particular portfolio there is no built-in bias toward any particular type of security. The typical portfolio consists of a mix of securities chosen in such a way as to balance the level of risk of the portfolio in relation to the potential for income and capital appreciation. ERISA's prudent man rule allows for investment in all types of assets.

But ABA will most strongly oppose any effort to dilute the prudence standard or to mandate the allocation in any type of socially desirable investment whether it be residential mortgages, industrial modernization or whatever. Our Association agree with Congress' decision in ERISA that the provision of retirement benefits for our nation's retired workers is, in an of itself, a social goal of the highest order. We would stand firmly against any attempt to weaken the fundamental standards in ERISA to further social ends of the day.

STATEMENT OF

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

on

The Elimination of Retroactive Withdrawal Liability (S. 2860)

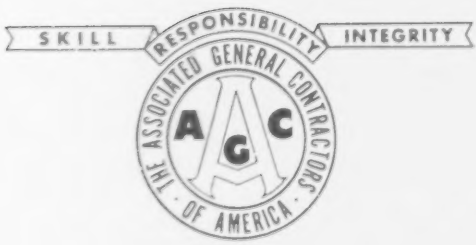
and

The Residential Mortgage Investment Act of 1982 (S. 2918)

SUBMITTED TO

The Subcommittee on Savings,
Pensions and Investment Policy
of the Senate Finance Committee

October 12, 1982



The Associated General Contractors of America (AGC) appreciates the opportunity to comment on two legislative proposals affecting multiemployer employee benefit plans which are currently being considered by this committee. One, the Residential Mortgage Investment Act of 1982 (S.2918), is designed to facilitate the involvement of employee benefit plans in mortgage transactions. This goal would, as we understand it, be achieved by relaxing certain prohibited transaction provisions currently embodied in the Employee Retirement Income Security Act (ERISA). The second proposal, S.2860, would eliminate the retroactive application of the Multiemployer Pension Plan Amendments Act of 1980 ("the 1980 amendments"). This provision of the 1980 amendments has been the cause of great controversy and is currently the subject of numerous legal challenges regarding its constitutionality.

AGC has long had a vital interest in the future of multiemployer employee benefit plans. AGC and its 113 chapters nationwide represent over 30,000 construction firms including 8,500 of America's leading general contractors. AGC member firms perform over $150 billion worth of construction work annually and employ more than 3.5 million individuals. They contribute on behalf of many of these employees to thousands of multiemployer employee benefit plans established through collective bargaining agreements. In addition, hundreds of these same contractors serve as trustees on multiemployer pension, health, and welfare funds.

At the outset, AGC would like to reemphasize its on-going commitment to continue to foster the maintenance and growth of multiemployer plan. These plans have proven to be a safe and effective vehicle for providing pensions and other benefits to workers in the construction industry. Employees have benefited from increased

financial stability created by a broad contribution base and from increased portability and transferability between employers. Employers have the advantage of sharing plan administration costs and being able to continue to provide their employees with steady benefits despite intermittent work. AGC considers it essential that any Congressional action in regard to multiemployer plans must protect the interests of plan participants.

S. 2860 - Elimination of Retroactive Withdrawal Liability

On September 26, 1980 the Multiemployer Pension Plan Amendments Act of 1980 was enacted into law. These amendments were intended to protect the benefits of multiemployer plan participants and beneficiaries and included various changes to the multiemployer plan termination insurance program which had been established by ERISA. By far the most significant change was the imposition of withdrawal liability on employers who cease contributing to plans which have unfunded vested benefits.

The withdrawal liability provisions of the 1980 amendments have created many problems for multiemployer plans, plan participants and beneficiaries and the employers who contribute to these plans. The imposition or potential imposition of hundreds of thousands, even millions, of dollars of withdrawal liability has prevented employers from making reasonable business decisions. In many cases the employer withdrawal liability has been so great that it threatens the financial stability of the employer. This further disrupts our economic system as the employers are forced into bankruptcy and thousands of gainfully employed workers lose their jobs.

One of the negative aspects of the withdrawal liability provisions is that the 1980 amendments made them effective prior to the enactment date of September 26, 1980. Thus, an employer who left a multiemployer

plan after April 28, 1980, but before September 26, 1980 could be assessed withdrawal liability despite the fact that at the time of the withdrawal the employer had no contractual or legal obligation to make such withdrawal liability payments. This after-the-fact application of withdrawal liability is clearly unjust and inequitable and has resulted in numerous lawsuits challenging the constitutionality of this retroactive application.

The Associated General Contractors of America fully supports the elimination of this improper and unreasonable application of the 1980 amendments. We have for some time been supporting efforts to change the 1980 multiemployer amendments and applaud this effort by Senators Danforth and Chafee. AGC would like, however, to add that there is an urgent need for even broader changes to the 1980 amendments. Without substantial modification, the 1980 amendments will likely destroy some of the very plans they were designed to protect.

A broad-based coalition of employers and trade associations in the construction, printing, meatpacking, retail and wholesale grocery, food processing, apparel, and wholesale-distributor industries has been working to develop a legislative proposal which would correct many of the current problems. After months of review, debate, and compromise a proposal has finally been agreed on and was recently introduced in the House of Representatives by Representative Ken Holland (D-SC). AGC would like to briefly outline the major aspects of H.R. 7233 - "The Multiemployer Retirement Income Protection Act" - as introduced by Representative Holland.

The cornerstone of H.R. 7233 is a provision which would require that a plan be well-funded before there can be a past service benefit increase or a grant of past service credit. Specifically, a plan must

have an assets to vested benefit ratio of .7 or greater in order to provide a past service benefit increase or grant of past service credit during the first four years after enactment. For subsequent plan years, the ratio must be .9 or better. AGC believes that a well-funded plan in and of itself provides the best protection for the pensions of covered workers and also eliminates one of the principal problems with the 1980 amendments. Contributing employers who bear the full burden of employer withdrawal and plan termination liability despite the fact that plan trustees can, and do, unilaterally increase plan benefits, will be protected against unreasonable benefit increases.

H.R. 7233 also removes the current disincentive which is associated with large amounts of potential withdrawal liability which is keeping new employers from participating in multiemployer plans. By requiring adequate funding levels as the bill proposes, new employers will be much more inclined to participate in multiemployer plans.

H.R. 7233 would also encourage better plan funding and strengthen the Pension Benefit Guaranty Corporation insurance system by implemeting risk-related premiums. Currently, all plans covered by PBGC's multiemployer plan termination insurance pay the same annual premium of $1.40 per participant. This flat rate does not vary regardless of potential risk of loss to PBGC, so that well-funded plans pay the same premium as do poorly funded plans.

H.R.7233 contains a provision to vary the rate of the premium paid to PBGC in accordance with the funding level of the plan. The better funded a plan is, the less risk to PBGC and the lower will be the annual premium. The more poorly funded, the higher the premium. In other words, the bill would provide a specific financial incentive for plans to quickly work towards better funding.

Another important goal of this bill is to reduce the impact of employer withdrawal liability under unusual situations which are totally beyond the control of the employer. Eliminating liability in these instances will reduce much of the anxiety currently felt by employers who are considering involvement in multiemployer plans.

The bill would also eliminate the retroactive application of the 1980 multiemployer amendments to withdrawals which occured prior to the enactment date, and is thus in accord with S.2860 which is currently before the committee.

H.R. 7233 contains numerous other changes which are designed to improve administration of the 1980 multiemployer amendments including changes to the current dispute resolution process to shift more of the burden of proof to the plan. The bill also contains provisions which will require PBGC to promulgate actuarial assumptions for use in calculating withdrawal liaiblity, clarify and extend current rules regarding transfers of assets and liabilities between plans, and prevent assessment of withdrawal liability when a plan is fully-funded.

AGC encourages this subcommittee, and other interested groups, to concentrate on the deeper problems of multiemployer employee benefits plans. It is AGC's position that any effective relief must provide for better funding of multiemployer plans in addition to other changes, if the promised benefits of covered workers are to be truly protected.

The Residential Mortgage Investment Act of 1982 (S. 2918)

AGC's position on pension fund investment is that trustees must invest plan monies "on the basis of maximized return consistent with safe investment and the Prudent Man Rule," as required by the

Employee Retirement Income Security Act of 1974 (ERISA). Compliance with the Prudent Man Rule requires trustees to seek the highest rate of return possible (in keeping with safe investment practices) and consider the broadest possible range of investment options.

As we understand the provisions of S. 2918, pension plans would be able to become directly involved in mortgage transactions without regard to the provisions of Section 406(a) of ERISA. These provisions currently prevent dealings between the pension plan and parties in interest by establishing a number of "prohibited transactions." Instead of these carefully defined requirements, S. 2918 would permit certain mortgage transactions if made at "arm's length" which is defined in the bill as being "in accordance with the customary practice in the residential mortgage industry."

We believe that the substitution of an "arm's length" standard for the clear and specific prohibited transaction sections of ERISA would be a mistake. These specific prohibitions were essential to a prime purpose of ERISA: to avoid situations where trustees become involved in dealings which could be of benefit to themselves, contributing employers, or plan fiduciaries. By eliminating these provisions with respect to mortgage investments, S. 2918 would create a major loophole in the effectiveness of ERISA, and would weaken protections against fund mismanagement.

We believe that pension plans which desire to become involved in mortgage investments already have the vehicles available through existing governmental-backed mortgage pools, or through privately-financed mortgage pools of the type recently approved by the Department of Labor (Prohibited Transaction Exemptions 82-87 and 81-7; 47 Fed. reg. 21241, May 18, 1982). Such investment vehicles provide plans with the opportunity to invest in housing without violating ERISA standards and at the same time safeguarding the benefits of plan participants.

Thank you for the opportunity of presenting our views to the Committee.

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

HILTON DAVIS
VICE PRESIDENT
LEGISLATIVE AND POLITICAL AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062
202/659-6140

September 27, 1982

The Honorable John H. Chafee, Chairman
Savings, Pensions and Investment Policy
Subcommittee
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the U.S. Chamber of Commerce and its over 250,000 members, many of whom participate in multiemployer collective bargaining agreements, I am pleased to support S. 2860 which would eliminate the retroactive effective date of the employer withdrawal liability provisions of the multiemployer Pension Plan Amendments Act of 1980 (P.L. 96-364).

Background

In 1980, Congress enacted P.L. 96-364 to remedy a seriously deficient multiemployer pension insurance program scheduled to become effective that year. If the deficiencies had remained uncorrected, several large union pension plans would have been terminated and their liabilities thrust upon other industries via the insurance program. These costly pension insurance premiums were expected to lead to more multiemployer pension terminations. If so, assets of single employer plans or general revenues eventually could have been needed to pay off the pension obligations.

The Act included a number of new requirements that would reduce the cost of the insurance, as well as the risk insured against. One feature -- withdrawal liability -- has proven to be exceedingly harsh and disruptive to normal business practices. Some firms leaving these collectively bargained pensions are being assessed liabilities that exceed the value of the firm. Often times, the decision to withdraw is beyond the control of the participating employer; nonetheless, withdrawal liability is imposed.

Chamber Position

The Chamber believes that the current withdrawal liability provisions are harsh, inequitable and highly disruptive and that legislative relief is warranted. Any legislative solution must result in an affordable and workable multiemployer insurance program that neither interferes unduly in the normal business practices of the participating firms nor violates the principles of a sound and sustainable multiemployer pension system.

Further, any multiemployer insurance program should (1) be separate from that of the single employer plans; (2) be free from general revenue support; (3) pay benefits only in event of unavoidable plan insolvency; and (4) foster the continuation of such plans rather than making their termination more attractive to covered industries.

Support

We support S. 2860, but I must note that it addresses only one aspect of the withdrawal liability nightmare -- withdrawals that occurred between April 29, 1980 and September 26, 1980. The problems created by withdrawal liability extend to all withdrawals, irrespective of when they occur. Therefore, I urge the subcommittee to address the entire scope of the withdrawal liability problem, and I offer the assistance of our professional pension staff, headed by Michael Romig, in drafting an appropriate resolution.

I will appreciate your consideration of our views and I respectfully request that this letter be made a part of the hearings record.

Cordially,

Hilton Davis

Hilton Davis

PRESIDENT
Bennett C. Whitlock, Jr.
(202) 797-5212

AMERICAN
TRUCKING
ASSOCIATIONS, INC.
1616 P Street, N.W., Washington, D. C. 20036

September 27, 1982

The Honorable John Chafee
Chairman
Subcommittee on Savings, Pensions
and Investment Policy
Senate Committee on Finance
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The American Trucking Associations, Inc. (ATA) appreciates the opportunity to present its statement on S.2860 introduced by the Honorable John C. Danforth of Missouri and by yourself. This bill, in major part, would eliminate the retroactive application of the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980 (hereafter MPPAA).

ATA is the national trade association of the trucking industry, a federation of associations in all 50 states and the District of Columbia. We speak for more than 22,000 firms regulated in interstate commerce as well as thousands of private fleets. ATA members are interested in S.2860 because of the "devasting" withdrawal liability problems which MPPAA has imposed on the trucking industry.

MPPAA is not working as Congress intended. The impact of this Act on the financial health of this industry has been devastating. If the Act is left unchanged, ultimately it will cause the demise of the unionized trucking companies and the very pension plans it was designed to protect.

The elimination of MPPAA's retroactive withdrawal liability from April 29 to September 26, 1980, would solve the withdrawal liability problems for a very limited number of motor carriers - 21 as far as we can determine. This provides no remedy for the trucking industry as a whole and does not begin to address the magnitude of the problem.

The retrospective impact of MPPAA's withdrawal liability extends far beyond the small number of companies that went out of business between April 29 and September 26, 1980. The impact extends to every company that was a party to a collective bargaining agreement before September 26, 1980 providing for contributions to a multiemployer pension fund. Because of their status before the enactment of MPPAA, such companies, just as much as those that went out of business during the retroactive period, are burdened by their pre-enactment actions.

Withdrawal liability requires an employer who joined a union-sponsored, multiemployer pension plan before enactment of MPPAA and who later withdraws for any reason to pay a withdrawal penalty that in many cases equals or exceeds the assets of the company. Withdrawal liability damages those unionized companies which must go out of business as well as those unionized companies which remain in business. Its mere existence as a contingent liability makes it difficult, if not impossible, to buy, sell, merge, or consolidate businesses. It has a negative impact on the movement of capital and reduces the ability of companies to borrow money. In sum, MPPAA detrimentally affects almost every major business decision.

No other industry has been harmed by MPPAA as much as the trucking industry.1/ This is because the timing of MPPAA could not have been worse. In July, 1980, Congress enacted the Motor Carrier Act of 1980 which fundamentally altered the rules for entering and competing in the trucking industry. The Motor Carrier Act encouraged the growth of non-union carriers with lower labor costs at the expense of small or marginally profitable unionized carriers with higher costs, thereby pushing the latter into an unprofitable situation.

MPPAA, passed 87 days later, fundamentally altered the rules for leaving the industry or otherwise dealing with the new competitive situation. The conjunction of these two statutes means that the harms caused by MPPAA pervade the unionized trucking industry - firms cannot leave the industry without paying withdrawal liability, they cannot compete in the industry as they are currently structured, and they cannot

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1/ For example, 48 of the 110 cases challenging the constitutionality of MPPAA were trucking industry cases as of June 28, 1982.

restructure without paying withdrawal liability.[2/] The inevitable result has confronted many unionized carriers with an agonizing dilemma. Their congressional mandated choices are: 1) to find buyers willing not only to assume unprofitable businesses but to assume their withdrawal liability; 2) to consume their assets by continuing to operate unprofitable businesses in order to avoid withdrawal liability; or 3) to assign their assets to pension plans as the price of discontinuing their unprofitable operations.

Thus, MPPAA has had a disastrous impact upon the trucking industry. This impact can be best understood by example.

The confiscatory nature of withdrawal liability is demonstrated by Dean Truck Line, Inc. Dean was an "interline" carrier, a hauler of long-distance shipments over an intermediate segment of the trip. Because other carriers were limited in the routes over which they could operate, Dean had a virtually guaranteed market. However, with the elimination of route restrictions, larger carriers could carry the freight themselves over Dean's routes. Dean's "niche" was thus eliminated and its only alternative was to go out of business, which it did in 1981. The Central States Fund assessed Dean's withdrawal liability at $687,000, an amount greater than Dean's net profits for the last 20 years.

The deterrent effect of withdrawal liability is demonstrated by the situation of T.I.M.E.-D.C. and East Texas Motor Freight Line, Inc. (ETMF). Because of efficiencies gained through consolidation of routes and terminals, the sale would save $14 to $18 million both companies had been losing annually and would create one profitable company where two unprofitable companies had previously existed. Every detail of the sale had been

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2/ Former Interstate Commerce Commissioner Thomas Trantum, in a statement before the Joint Economic Committee of the Congress on November 17, 1981, said, "At this point I would like to mention one additional development. The Multiemployer Pension Plan Amendments Act of 1980 made a partially or wholly withdrawing employer immediately liable for up to 100% of its net worth. Previously, withdrawal liability was limited to 30% of net worth over a period of time. In effect, the Amendments Act has made it very difficult for carriers to transfer assets, as well as move facilities from one area to another. As such, carriers face a new barrier in adjusting to market circumstances contrary to the intent of the Motor Carrier Act of 1980. I, therefore, urge Congress to review this matter and search for a solution."

negotiated except T.I.M.E.-D.C.'s withdrawal liability, but that last detail stopped the transaction. The two companies could not agree on how to allocate T.I.M.E.-D.C.'s estimated withdrawal liability of $29 million and ETMF could not justify the risk of assuming the liability. Consequently, an economically feasible and necessary sale was thwarted by withdrawal liability, and the two conpanies have since lost a total of $19 million as a direct result of MPPAA.

Even if a sale is successfully consummated, the buyer continues to be harmed, as demonstrated by Miller Transporters, Inc. In 1981, Miller purchased Wheeling Pipe Line Company and, because of the MPPAA requirements, had to post bonds totalling over $800,000 for the sale to go through. Moreover, the possibility of some business decision involving a cut-back of former Wheeling operations leading to liability on those bonds severely restricts Miller's freedom of operation.

Pozas Brothers also demonstrates MPPAA's burden on a company's ability to sell. Here, two brothers who have been in the trucking industry wish to sell their company and retire. Because of the company's contingent withdrawal liability of approximately $1.3 million, they cannot find a buyer and are forced to stay in business against their will.

MPPAA detrimentally affects other business decisions as attested by Oneida Motor Freight, Inc. The company closed a terminal and moved the employees to another terminal four miles away. Because the second terminal was in the jurisdiction of another Teamster plan, the company had to cease contributions to the Teamster plan that originally covered the employees, thus precipating a "withdrawal" penalty. The first plan assessed liability of $318,000 even though Oneida continues to make contributions for the employees in question to the second plan.

The deterrent factor of such rules on necessary business decisions is demonstrated by Lattavo Brothers, Inc. Lattavo sought to expand its operations in Pittsburgh to offset losses elsewhere. However, because of potential withdrawal liability it could not move its employees from a terminal on one side of Pittsburgh to a terminal on the other side - a move necessary to expand its Pittsburgh business. MPPAA thus foreclosed an opportunity that could have aided the company in reversing its recent downturn.

Finally, because withdrawal liability represents a claim on the company's assets, businesses have difficulty obtaining loans. The accounting profession is beginning to require the footnoting of withdrawal liability on company financial statements and the additional risk posed by withdrawal liability

forces banks to require security for a loan that otherwise would be made as an unsecured loan, to charge a higher rate of interest in order to compensate for the greater risk, or to decline to make the loan.

Therefore, MPPAA penalizes or bars most major business decisions. Because of MPPAA, such decisions as whether to go out of business, buy or sell a company, move a terminal, or seek a loan are burdened, penalized, or barred. Moreover, withdrawal liability can be imposed even because of government condemnation. Keith Fulton & Sons, Inc. had its property taken by right of eminent domain. Because it could not find another suitable location, it went out of business and was assessed over 40% of its net worth as its withdrawal penalty.

The elimination of the retroactive application of the withdrawal liability provisions of MPPAA as proposed in S.2860 does not begin to address these problems. Rather, it focuses its attention upon a single unfair application of MPPAA which applies to a very few trucking employers. Nevertheless, another solution which addresses all of the problems listed above is readily available to the 97th Congress. It provides a comprehensive remedy for the entire trucking industry. This solution would be the enactment of the industry agreement between ATA and the International Brotherhood of Teamsters as represented by the Central States and Western Conference of Teamster's Pension plans. The language of this agreement, together with several letters of endorsement, is attached to this statement.

The agreement contains three principles. First, it protects the insurance system contained in Title IV of ERISA for retirees and participants of Multiemployer pension plans. Second, it reduces the event triggering withdrawal liability in Teamster pension funds. Companies could go out of business, move out of the plan's jurisdiction, and, in most instances, sell their assets without triggering withdrawal liability. However, company decisions to go non-union would still trigger withdrawal liability. Third, it provides for sounder funding of Teamster pension funds.

This solution provides broad, constructive and urgently needed relief. It also addresses the particularly onerous effects MPPAA has had on the trucking industry in light of the timing with the Motor Carrier Act of 1980. Most mergers, consolidations, sales, and other business transactions encouraged by the Motor Carrier Act could take place without triggering withdrawal liability under MPPAA.

In conclusion, ATA urges you to prevent MPPAA from continuing to wreck havoc upon the trucking industry. This can best be accomplished by the enactment of the ATA agreement with the International Brotherhood of Teamsters. It cannot be accomplished solely by enactment of S.2860. We appreciate the opportunity you have given us to address this important matter and we request that this statement be included in the present hearing record of S.2860.

Sincerely,

Bennett C. Whitlock Jr.

Bennett C. Whitlock, Jr.

INTERNATIONAL BROTHERHOOD OF TEAMSTERS
CHAUFFEURS • WAREHOUSEMEN & HELPERS
OF AMERICA
25 LOUISIANA AVENUE, N.W. • WASHINGTON, D.C. 20001

OFFICE OF
• ROY L. WILLIAMS •
GENERAL PRESIDENT

July 8, 1982

The Honorable Donald L. Nickles, Chairman
Subcommittee on Labor
United States Senate
Washington, D.C. 20510

Dear Senator Nickles:

As you are aware, the withdrawal liability provisions of the Multiemployer Pension Plan Amendments of 1980 have resulted in major problems for many multiemployer pension plans and for the labor organizations and employers that maintain those plans. These problems have been especially acute in the trucking industry, which is attempting to adjust to the unprecedented changes imposed by the trucking industry deregulation legislation that was also enacted in 1980. Mergers, sales, consolidations and changes in operations have in many cases been thwarted by the specter of withdrawal liability. As a result, jobs in the trucking industry have been threatened by the inability of employers to make organizational changes dictated by the marketplace.

We believe that the problems caused by withdrawal liability can be addressed through responsible changes in the law that will fully protect the interests of plan participants, labor organizations, employers and the Pension Benefit Guaranty Corporation. Working with the two largest multiemployer pension plans in the transportation industry, the Central States Teamsters Pension Plan and the Western Conference of Teamsters Pension Plan, and with the American Trucking Association, we have developed and are submitting to Congress a legislative proposal that provides appropriate relief from the serious problems caused by withdrawal liability.

The Honorable Donald L. Nickles
Page Two

On behalf of the over two million members of the International Brotherhood of Teamsters, I urge your support for its speedy enactment.

Sincerely,

Roy L. Williams

Roy L. Williams
General President

RLW/ts
cc: Members of the Senate
Labor Subcommittee

PRESIDENT
Bennett C. Whitlock, Jr.
(202) 737-5212

AMERICAN
TRUCKING
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1616 P Street, N.W., Washington, D. C. 20036

July 14, 1982

The Honorable Orrin Hatch
Chairman
Committee on Labor and Human Resources
Unites States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On March 11 and 17, 1982, the Senate Labor Subcommittee held hearings on the "devastating" withdrawal liability problems which the Multi-Employer Act of 1980 had imposed upon the trucking industry. On the second day of hearings, representatives of the Teamsters' two largest pension funds -- the Central States and the Western Conference of Teamsters -- agreed that legislative modifications to the Multi-Employer Act were necessary. Accordingly, at the conclusion of the hearings, the Senate Labor Subcommittee urged the American Trucking Associations and the International Brotherhood of Teamsters, as represented by the Central States and Western Conference plans, to work out a compromise solution to the problems created by the Multi-Employer Act.

After weeks of meetings and discussions, we have reached such a compromise. Our approach, which will be forwarded under separate cover, contains three principles. First, it protects the insurance system contained in Title IV of ERISA for retirees and participants of multi-employer pension plans. Second, it reduces the events triggering withdrawal liability in Teamster pension funds. Companies could go out of business, move out of the plan's jurisdiction and, in most instances, sell their assets without triggering liability. However, company decisions to go non-union would still trigger liability. Third, it provides for sounder funding of multi-employer plans. In addition, the solution grants the PBGC new authority to reduce or eliminate withdrawal liability on a plan-by-plan basis for any pension fund based upon the financial fitness of the plan. It also proposes across-the-board reforms in such areas of asset sales and arbitration rules.

continued...

Taken together, the solution provides broad, constructive and urgently needed relief. It also addresses the particularly onerous effects the Multi-Employer Act has had on the trucking industry in light of motor carrier deregulation. The mergers, consolidations, sales and other business transactions encouraged by deregulation have triggered withdrawal liability under the Multi-Employer Act. Accordingly, the industry has been prevented from making sound management decisions which could aid their companies in coping with the impact of the Motor Carrier Act of 1980.

Given the serious and ongoing nature of our problems in this area, the American Trucking Associations would appreciate your prompt and favorable consideration of our proposed legislation.

Sincerely.

Bennett C. Whitlock, Jr.

Bennett C. Whitlock, Jr.

BCW:pmk

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John C. Culver
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July 14, 1982

Honorable Donald L. Nickles
Chairman, Subcommittee on Labor
Committee on Labor and Human
Resources
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

In the course of your hearings on S. 1748, I testified on behalf of the Trustees of the Central States, Southeast and Southwest Areas Pension Fund in connection with the problems which have arisen under the withdrawal liability provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). Our testimony referred to the possibility of formulating a corrective amendment to ERISA which would properly address the unique problems of multiemployer plans involving the transportation industry.

Since the close of your hearings in March, representatives of the Central States Pension Fund, the Western Conference of Teamsters Pension Trust Fund, the American Trucking Associations, and the International Brotherhood of Teamsters have succeeded in formulating a legislative proposal which addresses in a constructive and responsible fashion the needs and concerns of plan participants, contributing employees and the Pension Benefit Guaranty Corporation. The legislative proposal is the product of a unique cooperative effort in which the problems created by withdrawal liability from the standpoint of multiemployer plans, unions and employees were identified and addressed. As such, we feel that the legislative proposal is in the best interests of all concerned and would provide much needed relief in this increasingly controversial area.

We urge your support for the prompt enactment of this measure.

Sincerely,

John C. Culver

John C. Culver
Attorney
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July 13, 1982

Senator Donald L. Nickles
Chairman of the Subcommittee
on Labor
Committee on Labor and Human
Resources
United States Senate
6327 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Nickles:

At the conclusion of your hearings on S.1748 on March 17, 1982, you asked the interested groups in the trucking industry and related plans to work together to fashion a mutually acceptable solution to the problems caused by withdrawal liability under the Employee Retirement Income Security Act of 1974 ("ERISA"). After several months of effort, the Trustees of the Western Conference of Teamsters Pension Trust Fund, the American Trucking Associations, the International Brotherhood of Teamsters and the Trustees of the Central States Teamsters Pension Fund have developed a proposal that we believe represents a significant improvement in ERISA's withdrawal liability rules. We urge your support for its prompt enactment.

The Trustees of the WCT Fund have concluded that the long term effect of the current withdrawal liability rules could be to undermine the contribution base of the Fund by discouraging employer participation in the Fund. This could, in turn, impair the ability of the Fund to provide adequate retirement benefits for the more than half a million workers and retirees covered under the Fund, and increase the level of contributions required of employers who do participate in the Fund.

The withdrawal liability proposal that we support would provide significant and immediate withdrawal liability relief for all affected parties. In addition, it would provide the Pension Benefit Guaranty Corporation greater flex-

ibility in administering the multiemployer plan guarantee program so that the vastly differing needs of different multiemployer plans could be taken into account. Finally, it would make substantive changes in a variety of ERISA provisions where a consensus has developed that change is needed.

We appreciate your efforts in this area, and look forward to continuing to work with your Subcommittee during your consideration of these important issues.

Sincerely,

Theodore R. Groom

Theodore R. Groom
Attorney for
The Western Conference of
Teamsters Pension Trust Fund

cc: Members of the Senate
Labor Subcommittee

Interstate Commerce Commission
Washington, D.C. 20423

OFFICE OF LEGISLATIVE COUNSEL

July 12, 1982

Honorable Don Nickles
Chairman
Subcommittee on Labor
Senate Committee on Labor and
Human Resources
United States Senate
Washington, D.C. 20510

Mr. Chairman:

Thank you for requesting the views of the Interstate Commerce Commission with respect to a matter of great concern--the financial plight of the trucking industry and the fact that testimony before your Subcommittee indicated the industry may be "facing serious problems stemming from deregulation and the 1980 ERISA amendments."

First, let me state that the Commission does not believe that enactment of the Motor Carrier Act of 1980 has, in and of itself, caused financial harm to the industry. Instead, it is our view that it is the downturn in the economy that has caused the decline in the industry's financial performance. For a further explanation of this matter, I am attaching the Commission's recent testimony before the House Public Works Surface Transportation Subcommittee; that statement discusses the financial status of the industry in some depth. Also, in responding to questions at the House oversight hearing on June 23, 1982, I pointed out that many of the motor carriers presently in financial difficulty had experienced losses prior to enactment of the Motor Carrier Act.

Nevertheless, the Commission is aware of the problems created by the 1980 Multiemployer Pension Plan Amendments which, in conjunction with ERISA (The Employee Retirement Income Security Act of 1974), require an employer which wholly or partially withdraws from a pension plan to pay a prorata share of unfunded vested liability.

The withdrawal liability problems created by the 1980 ERISA amendments are very real and, as demonstrated at your hearings, have interfered in a number of instances with motor carrier decisions whether to transfer, sell or liquidate part or all of their operations. This problem, we believe, needs to be addressed by Congress.

I would also agree that the problems resulting from the Multiemployer Pension Plan Amendments have been particularly severe because of the timing of those amendments. The Motor Carrier Act became effective on July 1, 1980. That legislation contemplated changes in the motor carrier industry in line with the new guidelines intended to promote competitive and efficient transportation services. Less than three months later, the Pension Plan Amendments became effective, and prevented some carriers from ceasing operations despite the fact that they found themselves unable to compete in the new and more competitive environment resulting from the Motor Carrier Act. The situation was, of course, exacerbated by poor economic conditions.

I have recently been informed that concerned parties, including the American Trucking Associations and the Teamsters, have reached agreement on a substitute version of S. 1748, the "Multiemployer Pension Plan Stabilization Act of 1981." We were extremely pleased to learn that the parties have developed a compromise approach to withdrawal liability that should resolve the problems discussed in hearings before your Subcommittee in March of this year.

Your efforts in regard to this legislation are an important factor in the progress that has been made toward a solution to these problems, and I hope that a markup will be scheduled in the near future. If the Commission can be of any assistance to you or your staff, please let me know.

Sincerely,

Reese H. Taylor, Jr.
Chairman

September 23, 1982

A BILL

To amend the Employee Retirement Income Security Act of 1974, as amended, and the Internal Revenue Code, as amended, for the purpose of encouraging employer participation in private multiemployer pension plans by modifying the rules for employer withdrawal liability and creating incentives for sounder funding of certain multiemployer pension plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Multiemployer Improvements Act of 1982".

SEC. 2. TABLE OF CONTENTS.

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Sec. 101. Amendments to title IV of the Employee Retirement Income Security Act of 1974

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[to be supplied]

TITLE I - AMENDMENTS TO TITLE IV OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

SEC. 101. AMENDMENTS TO TITLE IV OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

Whenever, in this title, an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of the title IV of the Employee Retirement Income Security Act of 1974, as amended.

SEC. 102. COMPLETE WITHDRAWAL.

(a) Section 4203(d) is amended to read as follows:

"(d)(1) Notwithstanding subsection (a), in the case of an employer that has an obligation to contribute to a transportation industry plan, a complete withdrawal from such plan occurs only if --

"(A) the employer ceases to have an obligation to contribute under the plan, and

"(B) the employer --

"(i) continues to engage in a similar business in the same area of the plan,

"(ii) resumes a similar business in the same area of the plan within 5 years after the date on which the obligation to contribute under the plan ceased and does not renew the obligation, or

"(iii) sells, leases or otherwise transfers 85 percent or more of the assets it used in covered

operations to a purchaser or purchasers that use such assets in a similar business in the same area of the plan without having an obligation to contribute to the plan for such work.

"(2) For purposes of this title --

"(A) The term "transportation industry plan" means a multiemployer plan that, on or after enactment of the Multiemployer Improvements Act of 1982 --

"(i) is maintained pursuant to one or more collective bargaining agreements between employers and one or more employee organizations affiliated with a transportation labor organization;

"(ii) covers participants at least 10 percent of whom are employed by employers who are required to contribute to the plan for work performed, in whole or in part, in the transportation industry;

"(iii) does not have an accumulated funding deficiency under section 302 of this Act or section 412(a) of the Internal Revenue Code of 1954, as amended;

"(iv) is not in reorganization, as defined in section 4241(a), or insolvent, as defined in section 4245(b)(1); and

"(v) has plan assets with a value (determined as of the end of the preceding plan year) that equals or exceeds five times the total benefits paid by the plan in the preceeding plan year.

"(B) The term "transportation industry" means one or more of the following industries --

"(i) motor freight transportation and warehousing,

"(ii) local and suburban transit and inter-urban highway passenger transportation,

"(iii) air transportation, or

"(iv) transportation service.

"(C) The term "transportation labor organization" means an international labor organization whose affiliates are bargaining representatives of employees in the transportation industry and are the principal bargaining representatives of employees in the motor freight transportation industry.

"(D)(i) A plan that is or becomes a transportation industry plan shall continue to be treated as a transportation industry plan even if it subsequently fails to satisfy any of the conditions described in subparagraph (A).

"(ii) A continuation of a transportation industry plan resulting from a merger or transfer shall also be treated as a transportation industry plan, unless the merger or

transfer substantially changes the relevant characteristics of the plan.

"(E) A plan that is in reorganization or insolvent on the date of enactment of the Multiemployer Improvements Act of 1982 shall not be eligible to become a transportation industry plan.

"(3) For purposes of this title --

"(A) "Same area of the plan" means --

"(i) the same sub-area of the plan's jurisdiction (as defined by plan rules) in which the employer previously engaged in operations covered by the plan, or

"(ii) anywhere within the plan's jurisdiction, if more than 10 percent of the gross revenue of the employer's business is attributable to customers' operations in the same sub-area (or sub-areas) of the plan's jurisdiction in which the employer previously engaged in operations covered by the plan.

"(B) With respect to an employer that contributes to a transportation industry plan, a business will not be a similar business if the employer establishes that --

"(i) the employer was not previously obligated to contribute to the plan for such business;

"(ii) the business had been in existence for 3 years prior to the cessation of the employer's obligation to contribute to the plan; and

"(iii) within the first 3 years after the cessation occurs, the operations of such business have not increased or been maintained as a result of work performed in the same area of the plan for customers for whom the employer had previously performed work covered by the plan.

"(4) Notwithstanding paragraph (1), a complete withdrawal does not occur if --

"(A) the work that would otherwise result in a withdrawal is performed by employees who are represented by a different organization (or organizations) affiliated with the same transportation labor organization as employees who are covered by the plan;

"(B) the employer is obligated to contribute to a multiemployer plan for work performed by such employees; and

"(C) the change is approved by a change of operations committee established under the collective bargaining agreement which covers the work previously covered by the plan.

"(5) (A) Notwithstanding paragraph (1)(B)(iii), no withdrawal shall occur as a result of a sale of an employer's assets --

"(i) in connection with a liquidation of the employer or a portion of the employer under the Bankruptcy Code;

"(ii) at a public auction to more than one purchaser, if the purchasers are not related to each other or the seller and no purchaser acquires 85 percent or more of the seller's assets; or

"(iii) to 5 or more purchasers that are not related to each other or the seller, if no purchaser acquires more than 40 percent of the seller's assets.

"(B) In determining whether a withdrawal has occurred under paragraph (1)(B)(iii) a series of coordinated sales shall be treated as a single transaction.

"(6)(A) Liability shall be determined without regard to this subsection for an employer who ceases to have an obligation to contribute to the plan or ceases covered operations --

"(i) in a year in which, as a result of such cessations, substantially all of the contribution base units are withdrawn from the plan; or

"(ii) as part of an agreement or arrangement among employers to withdraw substantially all of the contribution base units from the plan.

"(B) For purposes of this paragraph, if substantially all of a plan's contribution base units are withdrawn from the plan within a 3 year period, an employer who has ceased to have an obligation to contribute or ceased covered operations during such period shall be presumed to have

ceased pursuant to an agreement or arrangement unless the employer proves otherwise by a preponderance of the evidence.

"(7) If an employer (hereinafter "the seller") who contributes to a transportation industry plan sells its assets, none of the seller's required contributions shall be attributed to the purchaser of the assets in calculating liability of such purchaser under this part for a subsequent withdrawal."

(b) Section 4203 is amended by adding at the end thereof new subsections (g) and (h) to read as follows:

"(g)(1) The corporation may approve rules under which withdrawal liability is reduced or eliminated for a multiemployer plan. Such rules may change the definition of a complete or partial withdrawal, the amount of withdrawal liability, or both. Such rules shall not expand the definition of complete or partial withdrawal to include an event that would not otherwise constitute a withdrawal under this subtitle. Any rule proposed by the parties described in paragraph (2)(A)(ii) and approved by the corporation shall supercede any conflicting plan rule.

"(2)(A) Approval of a rule reducing or eliminating withdrawal liability for a plan may be requested only by --

"(i) the plan sponsor of the plan; or

"(ii) jointly by labor organizations and employers (or employer organizations) that represent 25 percent or more of the contributions to the plan.

"(B) The parties described in subparagraph (A)(ii) may request approval for the same or similar rules for more than one plan in which they represent 25 percent or more of the required contributions to the plan.

"(3) Before approving a rule that reduces or eliminates withdrawal liability, the corporation --

"(A) shall publish a notice in the Federal Register that it is considering a request for approval of such a rule,

"(B) shall require that adequate notice be given to interested parties, and

"(C) shall afford interested parties an opportunity to present their views.

"(4) The corporation shall approve a rule reducing or eliminating withdrawal liability if the corporation determines that the rule --

"(A) would not significantly increase the risk of loss to the corporation, and

"(B) would be in the long term interest of participants and beneficiaries of the plan (taking into consideration such factors as whether the rule would make the plan more attractive to new employers or would otherwise strengthen the contribution base of the plan).

"(5)(A) If a financially sound plan adopts a rule under this subsection that reduces withdrawal liability, the rule shall be deemed approved by the corporation unless, within 180 days after the rule is submitted for approval, the corporation finds on the basis of clear and substantial evidence that the rule does not satisfy the criteria described in paragraph (4).

"(B) For purposes of this subsection, a plan is financially sound if --

"(i) the plan is not in reorganization as defined in section 4241(a) or insolvent as defined in section 4245(b)(1), and

"(ii) the assets of the plan equal or exceed seven times the total annual benefit payments of the plan.

"(6) In determining whether to approve a rule eliminating withdrawal liability, the corporation shall consider --

"(A) the extent to which plan assets equal or exceed plan benefits guaranteed under section 4022A;

"(B) the extent to which the unfunded liabilities of the plan are being amortized more rapidly than required by section 302(b) or section 412 of the Internal Revenue Code;

"(C) whether the plan's contribution base is diversified geographically or among different industries, or both;

"(D) whether the plan is likely to undergo significant financial decline in the foreseeable future;

"(E) whether, and the extent to which, the plan has relied upon the shortfall funding method to avoid a funding deficiency during the preceding 10 plan years; and

"(F) whether the plan has had an accumulated funding deficiency during the preceding 10 plan years or would have experienced a funding deficiency but for a minimum funding waiver under section 303 or contributions in excess of regularly-bargained levels.

"(7) If the application for approval was filed by the parties described in paragraph (2)(A)(ii), the corporation shall not approve such rule if the plan sponsor opposes the rule.

"(8) The corporation may condition its approval on the plan's agreement to satisfy any continuing financial conditions (and related reporting requirements) that the corporation determines are necessary to protect the multiemployer insurance system. The corporation may not revoke its approval of a plan's rule because the plan fails to satisfy such conditions, but may bring an action against the plan to enforce the agreement.

"(9) The corporation may determine that a rule reducing withdrawal liability constitutes an elimination of withdrawal liability (rather than a reduction) unless --

"(A) continuation or resumption of operations in some specified portion of the plan's jurisdiction without an obligation to contribute to the plan for such operations would constitute a withdrawal under such rule, and

"(B) the amount of an employer's withdrawal liability under the rule would equal or exceed the lesser of --

"(i) the employer's share of the increase in unfunded vested benefits for the plan years that the employer had an obligation to contribute to the plan, or

"(ii) the amount of the employer's withdrawal liability determined under this part without regard to the plan rule.

"(h) A complete or partial withdrawal of an employer does not occur if --

"(1) the employer ceases to contribute to the plan for work performed under contract;

"(2) as a result of competitive bidding, another employer performs such work; and

"(3) the second employer has an obligation to contribute to the plan for such work."

SEC. 103. SALE OF ASSETS.

Section 4204 is amended to read as follows:

"SALE OF ASSETS

"SEC. 4204. (a) A complete or partial withdrawal of an employer (hereinafter in this section referred to as the "seller") under this subtitle shall not occur if --

"(1) the seller ceases covered operations or ceases to have an obligation to contribute for such operations as a result of a bona fide, arm's-length sale of assets to an unrelated party (hereinafter in this section referred to as the "purchaser");

"(2) the purchaser is obligated under a collective bargaining agreement to make contributions to the plan for such operations; and

"(3) the purchaser agrees in writing that its liability with respect to any subsequent complete or partial withdrawal shall be determined as if the purchaser had been required to contribute to the plan the same amount that the seller was required to contribute for such operations for all previous years.

"(b) For purposes of this section, the term "unrelated party" means a purchaser or seller who does not bear a relationship to the seller or purchaser as the case may be, that is described in section 267(b) of the Internal Revenue Code of 1954,

or that is described in regulations prescribed by the corporation applying principles similar to the principles of such section.

"(c) For a sale of assets to more than one purchaser, the corporation shall prescribe by regulation the manner in which the seller's required contributions shall be allocated among the purchasers.

"(d) The plan sponsor may vary the requirement of subsection (a)(3) if it determines that the variance would be in the best interest of the participants and beneficiaries."

SEC. 104. PARTIAL WITHDRAWAL

Section 4208(d) is amended by adding at the end thereof a new paragraph (3) as follows:

"(3) (A) With respect to a transportation industry plan defined in section 4203(d)(2), a partial withdrawal occurs only if --

"(i) the employer permanently ceases to have an obligation to contribute under one or more but fewer than all of the collective bargaining agreements under which the employer has been obligated to contribute under the plan but continues a similar business in the same area of the plan, as defined in section 4203(d)(3), without having an obligation to contribute to the plan for such work;

"(ii) the employer permanently ceases to have an obligation to contribute under the plan with respect to work performed at one or more but fewer than all of its facilities, but continues a similar business at the facility;

"(iii) the employer sells, leases or otherwise transfers 85 percent or more of the assets it used in covered operations to a purchaser (or purchasers) that uses such assets in a similar business in the same area of the plan without having an obligation to contribute to the plan for such work; or

"(iv) the employer's obligation to contribute under the plan is continued for no more than an insubstantial portion of its work in the same area of the plan of the type for which contributions are required.

"(B) A partial withdrawal shall not occur if the conditions described in section 4203(d)(4)(A)-(C) are satisfied.

"(C) Notwithstanding subparagraph (A)(iii), a partial withdrawal shall not occur as a result of a sale of an employer's assets if --

"(i) the sale is described in section 4203(d)(5)(A) or

"(ii) in the plan year of the sale or the following plan year, the employer's contribution base units exceed 30 percent of the employer's average contribution base units for the 5 plan years ending before the sale.

"(D) For purposes of subparagraph (A)(i), an employer that contributes to the plan for work performed for regular long-term customers shall not be treated as continuing a similar business if the employer --

"(i) ceases to have an obligation to contribute to the plan for work performed under one but not all collective bargaining agreements and

"(ii) performs similar work for different customers than the customers for whom the employer previously performed work covered by the plan."

Sec. 105 OTHER WITHDRAWAL LIABILITY RULES

(a) Section 4224 is amended by adding at the end thereof a new sentence to read as follows:

"The plan sponsor or an authorized fiduciary may compromise, abandon, or otherwise refuse to pursue a claim for withdrawal liability if the projected cost of collection or other factors indicate that the refusal is consistent with section 404(a)(1)."

(b) Section 4219(c) is amended by deleting paragraph (2) and inserting in lieu thereof the following new paragraph:

"(2)(A) Withdrawal liability shall be payable in accordance with the schedule set forth by the plan sponsor under subsection (b)(1) beginning no later than 60 days after the date of the demand.

"(B) Notwithstanding subparagraph (A), if an employer requests a review of the plan sponsor's determination under subsection (b)(2)(A), the employer may elect to post a bond or pay an amount into escrow. The annual amount of the bond or escrow shall equal the amount of the employer's regular contributions to the plan in the last plan year ending before the alleged withdrawal. The bond or escrow shall be posted or paid at the same intervals as the schedule of withdrawal liability payments set forth by the plan sponsor."

(c) Section 4219 is amended by adding at the end thereof a new subsection to read as follows:

"(e)(1) If an event occurs that the plan sponsor of a transportation industry plan described in section 4203(d)(2) has determined may constitute a complete or partial withdrawal, the plan sponsor --

"(A) shall notify the employer that the event has occurred;

"(B) shall consider any evidence presented by the employer within 60 days after the date on which the notice was sent to the employer that the employer considers relevant to show that a withdrawal has not occurred, and

"(C) shall not issue a notice and demand for withdrawal liability until 60 days after the notice described in subparagraph (A) was sent.

"(2) The plan may require the employer to provide reasonable notice annually as to events that could constitute a withdrawal for each of the five years following the cessation of an employer's obligation to contribute to the plan.

"(3) If an employer presents evidence to the plan sponsor to show that a withdrawal has not occurred, the plan sponsor may not assert a claim for withdrawal liability unless the plan sponsor notifies the employer, within 120 days after the evidence is received by the plan, that it believes that a withdrawal has occurred.

"(4) If a notice and demand for withdrawal liability is issued, the employer may request a review of that plan sponsor's decision under subsection (b)(2)(A). Any dispute shall be resolved under subsection (b)(2) and section 4221.

"(5) The plan may assess and collect withdrawal liability on the basis of facts reasonably available to the plan and without regard to facts that are primarily within the employer's knowledge and control, unless the employer establishes those facts."

(d) Section 4211(c)(5) is amended by adding at the end thereof the following new subparagraph:

"(E) If the plan has no unfunded vested benefits at the end of a plan year --

"(i) the unfunded vested benefits allocable to any employer that withdraws from the plan in the next plan year shall be zero; and

"(ii) no portion of the plan's unfunded vested benefits for any previous year shall be attributed to any employer."

SEC. 106. PREMIUMS AND GUARANTEES.

(a) Section 4022A (relating to multiemployer plan benefits guaranteed) is amended --

(1) by striking out the word "The" at the beginning of subsection (a) and inserting in lieu thereof "Except as provided in subsection (i), the";

(2) by adding at the end thereof a new subsection (i) to read as follows:

"(i) The plan sponsor of a transportation industry plan described in section 4203(d)(2)(A) may elect to eliminate all guarantees under this section (and reduce premiums under section 4006(a)(3)) if --

"(1) the plan sponsor determines that the election is in the best interests of the participants and beneficiaries;

"(2) the vested benefits under the plan are fully funded or are being amortized substantially more rapidly than required by section 302;

"(3) for each plan year ending after September 2, 1974, the plan has satisfied the minimum funding requirement of section 302 without regard to --

"(A) the shortfall funding method or

"(B) a minimum funding waiver under section 303; and

"(4) the plan's contribution base is highly diversified both geographically and among different industries.

The corporation shall prescribe regulations implementing this subsection."

(c) Section 4006(a)(3) is amended --

(1) by adding a new subparagraph (E) at the end thereof to read as follows:

"(E) If a plan described in section 4022A(i) elects to eliminate all guarantees under section 4022A, the annual premium rate payable to the corporation by such plan shall equal one-half of the rate payable by multiemployer plans under this section."

(2) by deleting "subparagraph (C)" in subparagraph (A) and inserting in lieu thereof "subparagraphs (C) and (E)".

SEC. 107. REORGANIZATION AND INSOLVENCY.

(a) Section 4241 (relating to reorganization status) is amended by adding at the end thereof a new subsection (c) to read as follows:

"(e) A transportation industry plan described in section 4243(h)(3)(E) shall be treated as a plan in reorganization for purposes of section 4243(h) if the plan has a special funding deficiency in both share periods, as defined in section 302(d)(1), and in the first bargaining period after the second share period."

(b) Section 4243 (relating to the minimum contribution requirement) is amended by adding at the end thereof a new subsection (h) to read as follows:

"(h)(1) An employer that has an obligation to contribute to a transportation industry plan that is in reorganization or insolvent shall not be liable for any portion of an accumulated funding deficiency of such plan if the employer contributed to the plan, for each plan year that the plan is in reorganization or insolvent, an amount equal to the sum of --

"(A) the employer's contribution obligation for the plan year, and

"(B) the greater of --

"(i) the employer's reorganization contribution for the plan year, or

"(ii) if the employer is obligated to make a special contribution for an earlier share period under section 302(d)(2), such special contribution.

"(2) An employer's reorganization contribution for a plan year equals the lesser of --

"(A) 7 percent of the employer's contribution obligation for the plan year; or

"(B) the excess of --

"(i) 50 percent of the employer's average annual contribution obligation for the first plan year to which this paragraph applies in any 10 year period, over

"(ii) the total of the employer's reorganization contributions for the preceeding 9 plan years.

"(3) For purposes of this subsection --

"(A) "Average annual contribution obligation" means the average of an employer's contribution obligation for the lesser of --

"(i) the preceeding 10 plan years, or

"(ii) the number of plan years that the employer has contributed to the plan.

"(B) "Bargaining period" means a period of 3 plan years. The first bargaining period shall begin no later than January 1, 1984.

"(C) "Contribution obligation" means, for a plan year, the employer's required contributions for such plan year, as set forth in the collective bargaining agreement or agreements that require the employer to contribute to the plan (without regard to any reference to the special contributions or reorganization contributions required under this subsection).

"(D) "Special funding deficiency" means, for a plan year, a plan's accumulated funding deficiency determined without regard to the shortfall method and without regard to contributions required by this subsection for that plan year.

"(E) "Transportation industry plan" means a transportation industry plan described in section 4203(d)(2), whether or not such plan has been amended as permitted under section 4203(f) or (g)."

SEC. 108. TERMINATION.

(a) Section 4041A is amended by adding at the end thereof a new subsection to read as follows:

"(g)(1) The plan sponsor of a transportation industry plan shall not terminate the plan by amendment unless --

"(A) the plan sponsor notifies the parties that negotiate the principal collective bargaining agreement for the plan at least 60 days before the earlier of --

"(i) the date on which the amendment is adopted or

"(ii) the date on which the amendment takes effect;

"(B) the termination is approved by a majority of the employer trustees and a majority of the employee trustees for the plan; and

"(C) if plan assets are less than seven times benefit payments in the preceding plan year, the termination is approved by the parties to the principal collective bargaining agreement for the plan that represent employers and employees who peform work covered by the plan.

"(2) For purposes of this subsection, the term "principal collective bargaining agreement" means --

"(A) the principal collective bargaining agreement covering work in the motor freight industry, or

"(B) if less than 10 percent of the contributions to the plan are for work in the motor freight industry, the collective bargaining agreement or agreements designated by the plan sponsor.

"(3) With respect to a transportation industry plan that had assets that equalled or exceeded seven times total annual benefit payments as of the end of the first plan year ending after September 26, 1980, "five" shall be substituted for "seven" in paragraph (1)(C)."

(b) Section 4042 (relating to termination by the corporation) is amended by adding at the end thereof the following new subsection:

"(i)(1) If a transportation industry plan is terminated under this section, the minimum funding requirements under section 302 and section 4243 shall be determined on the basis of the lesser of --

"(A) unfunded vested benefits under the plan, or

"(B) unfunded benefits guaranteed by the corporation under section 4022A.

"(2) If a transportation industry plan terminated under this section has assets in any plan year that equal the lesser of the amounts described in paragraph (1)(A) or (B), the requirements of section 302 and section 4243 shall not apply to the plan for any subsequent plan year and no employer that withdraws from the plan in that plan year or any subsequent plan year shall be liable under part 1 of subtitle E."

SEC. 109. TRANSITION RULES AND EFFECTIVE DATES.

(a) Section 4402 (relating to transition rules and effective dates) is amended by adding at the end thereof a new subsection (h) to read as follows:

"(h)(1) Except as otherwise provided in this section, the amendments made to this title by the Multiemployer Improvements Act of 1982 shall take effect on the date of the enactment of tha Act.

"(2) With respect to a plan that is a transportation industry plan described in section 4203(d)(2) on the date of enactment of the Multiemployer Improvements Act of 1982, the amendments to sections 4203(d), 4208(d)(3), 4219 and 4224 take effect on April 29, 1980. Any withdrawal liability paid to such a plan for an event that was a withdrawal before enactment of that Act but is not a withdrawal after enactment of that Act shall be repaid to the employer within 60 days after enactment of that Act, without interest.

"(3) Nothing in the Multiemployer Improvements Act of 1982 shall expand the list of events that would constitute a complete or partial withdrawal under this title."

TITLE II - AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 201. AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954.

Whenever, in this title, an amendment is expressed in terms of an amendment to a section or other provisions, the reference is to a section or other provision of the Internal Revenue Code of 1954.

SEC. 202. TRANSPORTATION INDUSTRY PLANS.

(a) Section 413 is amended by adding at the end thereof a new subsection (d) to read as follows:

"(d) Transportation Industry Plans.

"(1) Share periods. (A) If a transportation industry plan, other than a plan that is in reorganization or insolvent, has a special funding deficiency for any plan year in a bargaining period, each of the next two bargaining periods shall be considered a share period. If the plan has a special funding deficiency for any plan year in a share period --

"(i) the plan sponsor shall reduce benefit costs (to the extent permitted under section 411 and section 412(c)(8)) with a value equal to the amount described in subparagraph (B); and

"(ii) each employer that is obligated to contribute to the plan during the share period shall make a special

contribution for the share period equal to the amount described in subparagraph (C).

"(B) The amount described in this paragraph equals the least of --

"(i) one-half the amount necessary to eliminate the special funding deficiency for each plan year during the second agreement,

"(ii) the amount necessary to reduce the net charge to the funding standard account for the plan in each subsequent plan year by 10 percent, or

"(iii) 30 percent of the average annual contribution obligations of all employers that contribute to the plan.

"(C) An employer's special contribution for a share period equals the product of the amount described in paragraph (B) and a fraction --

"(i) the numerator of which is the employer's average annual contribution obligation to the plan, and

"(ii) the denominator of which is the total average annual contribution obligations of all employers that contribute to the plan.

No employer's special contribution for any plan year shall exceed 10 percent of its average annual contribution obligation. Any contribution that cannot be made during a plan year as a result

of the preceding sentence shall be made in the subsequent plan year or plan years in amounts equal to 10 percent of the average annual contribution obligation (or the remaining balance, if less).

"(D) A plan shall be treated as a plan in reorganization for purposes of this subsection if the plan has a special funding deficiency in both share periods and in the first bargaining period after the second share period. If the plan is not in reorganization in the first bargaining period after the second share period, this paragraph shall apply to the plan again beginning with the first bargaining period in which the plan has a special funding deficiency and each of the next two bargaining periods shall be treated as a share period.

"(E) A reduction in benefit costs resulting solely from a change in actuarial assumptions or valuation shall not be treated as a reduction of benefit costs for purposes of subparagraph (A)(i).

"(2) Excise taxes. (A) For purposes of section 412 and section 4971, beginning with the first share period for a plan, an employer that maintains a transportation industry plan that is not in reorganization or insolvent shall not be liable for any portion of the accumulated funding deficiency for a plan year in which the employer contributed to the plan an amount equal to the sum of --

"(i) the employer's contribution obligation for the plan year, and

"(ii) the employer's special contribution for the plan year, if any, as determined under paragraph (1)(C).

"(B) Any funding deficiency otherwise attributable to an employer who satisfies this subparagraph shall be treated as an experience loss for purposes of section 412(b).

"(C) This paragraph shall not apply to any plan year in which the rate at which the employer is required to contribute to the plan is reduced below the highest rate in any preceding plan year.

"(3) Reorganization and insolvency. An employer that has an obligation to contribute to a transportation industry plan that is in reorganization or insolvent shall not be liable for any portion of an accumulated funding deficiency of such plan if the employer contributed to the plan, for each plan year that the plan is in reorganization or insolvent, an amount equal to the sum of --

"(A) the employer's contribution obligation for the plan year, and

"(B) the greater of --

"(i) the employer's reorganization contribution for the plan year, or

"(ii) if the employer is obligated to make a special contribution for an earlier share period under paragraph (1)(C), such special contribution.

"(4) Reorganization contribution. An employer's reorganization contribution for a plan year equals the lesser of --

"(A) 7 percent of the employer's contribution obligation for the plan year; or

"(B) the excess of --

"(i) 50 percent of the employer's average annual contribution obligation for the first plan year to which this paragraph applies in any 10 year period, over

"(ii) the total of the employer's reorganization contributions for the preceeding 9 plan years.

"(5) Definitions. For purposes of this subsection --

"(A) "Average annual contribution obligation" means the average of an employer's contribution obligation for the lesser of --

"(i) the preceeding 10 plan years, or

"(ii) the number of plan years that the employer has contributed to the plan.

"(B) "Bargaining period" means a period of 3 plan years. The first bargaining period shall begin no later than January 1, 1984.

"(C) "Contribution obligation" means, for a plan year, the employer's required contributions for such plan year, as set forth in the collective bargaining agreement or agreements that require the employer to contribute to the plan (without regard to any reference to the special contributions or reorganization contributions required under this subsection).

"(D) "Net charge to the funding standard account" means the excess, if any, of the charges under section 412(b)(2) over the credits under section 412(b)(3)(B).

"(E) "Special funding deficiency" means, for a plan year, a plan's accumulated funding deficiency determined without regard to the shortfall method and without regard to contributions required by this subsection for that plan year.

"(F) "Transportation industry plan" means a transportation industry plan described in section 4203(d)(2) of the Employee Retirement Income Security Act of 1974, whether or not such plan has been amended as permitted under section 4203(f) or (g) of such Act.

"(6) Increased benefit costs. For a transportation industry plan, the annual benefit cost shall not be increased in any plan year in which the plan --

"(A) has a special funding deficiency,

"(B) is in reorganization, or

"(C) is insolvent."

TITLE III - AMENDMENT TO TITLE I OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

SEC. 301. Amendments to Title I of the Employee Retirement Income Security Act.

Whenever, in this title, an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of title I of the Employee Retirement Income Security Act of 1974.

SEC. 302. MINIMUM FUNDING STANDARDS.

Section 302 is amended by redesignating subsection (d) as subsection (e) and by adding a new subsection (d) after subsection (c) to read as follows:

"(d)(1) If a transportation industry plan, other than a plan that is in reorganization or insolvent, has a special funding deficiency for any plan year in a bargaining period, each of the next two bargaining periods shall be considered a share period. If the plan has a funding deficiency for any plan year in a share period --

"(A) the plan sponsor shall reduce benefit costs (to the extent permitted by subsection (c)(8) and sections 204 and 206) with a value equal to the amount described in paragraph (2); and

"(B) each employer that has an obligation to contribute to the plan during the share period shall make a special contribution for the share period equal to the amount described in paragraph (3).

"(2) The amount described in this paragraph equals the least of --

"(A) one-half the amount necessary to eliminate the special funding deficiency for each plan year during the second agreement,

"(B) the amount necessary to reduce the net charge to the funding standard account for the plan in each subsequent plan year by 10 percent, or

"(C) 30 percent of the average annual contribution obligations of all employers that contribute to the plan.

"(3) An employer's special contribution for a share period equals the product of the amount described in paragraph (2) and a fraction --

"(A) the numerator of which is the employer's average annual contribution obligation to the plan, and

"(B) the denominator of which is the total average annual contribution obligations of all employers that contribute to the plan.

No employer's special contribution for any plan year shall exceed 10 percent of its average annual contribution obligation. Any

contribution that cannot be made during a plan year as a result of the preceding sentence shall be made in the subsequent plan year or plan years in amounts equal to 10 percent of the average annual contribution obligation (or the remaining balance, if less).

"(4) A plan shall be treated as a plan in reorganization for purposes of this section and section 4243(h) if the plan has a special funding deficiency in both share periods and in the first bargaining period after the second share period. If the plan is not in reorganization in the first bargaining period after the second share period, this subsection shall apply to the plan again beginning with the first bargaining period in which the plan has a special funding deficiency and each of the next two bargaining periods shall be treated as a share period.

"(5) For purposes of this subsection --

"(A) "Average annual contribution obligation" means the average of an employer's contribution obligation for the lesser of --

"(i) the preceeding 10 plan years, or

"(ii) the number of plan years that the employer has contributed to the plan.

"(B) "Bargaining period" means a period of 3 plan years. The first bargaining period shall begin no later than January 1, 1984.

"(C) "Contribution obligation" means, for a plan year, the employer's required contributions for such plan year, as set forth in the collective bargaining agreement or agreements that require the employer to contribute to the plan (without regard to any reference to the special contributions or reorganization contributions required under this subsection).

"(D) "Net charge to the funding standard account" means the excess, if any, of the charges under section 412(b)(2) of the Internal Revenue Code over the credits under section 412(b)(3)(B) of such Code.

"(E) "Special funding deficiency" means, for a plan year, a plan's accumulated funding deficiency determined without regard to the shortfall method and without regard to contributions required by this subsection for that plan year.

"(F) "Transportation industry plan" means a transportation industry plan described in section 4203(d)(2), whether or not such plan has been amended as permitted under section 4203(f) or (g).

"(6) For a transportation industry plan, the annual benefit cost shall not be increased in any plan year in which the plan --

"(A) has a special funding deficiency,

"(B) is in reorganization, or

"(C) is insolvent."

SEC. 303. DISCLOSURE AND REPORTING.

Section 101 (relating to duty of disclosure and reporting) is amended by redesignating subsection (d) as subsection (e) and inserting a new subsection before such redesignated subsection (c) to read as follows:

"(d) In the event that the actuary for a transportation industry plan (as defined in section 4203(d)(2)(A)) determines that the plan has or is reasonably expected to have an accumulated funding deficiency under section 302 or section 4243 --

"(1) the actuary shall notify the plan administator within 30 days after the actuary makes such determination, and

"(2) the plan administrator shall notify each employer who is required to contribute to the plan within 60 days after the plan administrator learns of such determination."

TITLE IV - MISCELLANEOUS PROVISIONS

Sec. 401 ACTION TAKEN BEFORE REGULATIONS ARE PRESCRIBED

(a) Except as otherwise provided in the amendments made by this act and in subsection (b), if the way in which any such amendment will apply to a particular circumstance is to be set forth in regulations, any reasonable action during the period before such regulations take effect shall be treated as complying with such regulations for such period.

(b) Subsection (a) shall not apply to any action which violates any instruction issued, or temporary rule prescribed, by the agency having jurisdiction but only if such instruction or rule was published, or furnished to the party taking the action, before such action was taken.